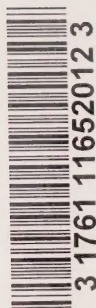


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Government
Publications

I-88-1D



Industry-Wide Hearing Part 4

Personal Vehicle-Private Passenger Automobile
Insurance Rates

DECISION WITH REASONS

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pt. 4

I-88-1D



IN THE MATTER OF the Ontario Automobile
Insurance Board Act, 1988, S.O. 1988, c.18;

AND IN THE MATTER OF an industry-wide hearing by
the Ontario Automobile Insurance Board pursuant
to section 20 of the said Act.

BEFORE: John P. Kruger
Chairman and Presiding Member

M. Elizabeth Atcheson
Vice Chair

M. Patricia Richardson
Vice Chair

Alvin Field
Member

Frank Marchington
Member

Lorna Ann Milne
Member

February 13, 1989

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EXECUTIVE SUMMARY

The Board, following 12 full days of hearings and 2 evening sittings commencing December 12, 1988 and ending January 13, 1989; and after careful consideration of all the evidence, including over 4,000 pages of transcript, over 580 exhibits, and over 430 submissions from the public and arguments from the parties; has decided that the average industry-wide benchmark rate increase should be approximately 7.6 percent. This benchmark is to be bound by a range of +9 to -20 percentage points.

The Board has made decisions with respect to how much total premium revenue companies will be permitted the opportunity to collect, and how much persons with different risk characteristics will contribute to the total revenue, for the period March 15, 1989 to December 31, 1989.

In prior parts of this Industry-Wide Hearing, the Board adopted a uniform classification plan (Board Class Plan) with standard rules and definitions; a standard rate making methodology; and underwriting margins for use in the calculation of proposed rates for 1989. The Board also established a Board Statistical Plan.

The Board Class Plan incorporates the legislated removal of age, sex, marital status, family status and handicap as rating factors. As such, the rate changes resulting from this Decision have two fundamental components. The first is the dislocation arising from the removal of these discriminatory rating factors and the transition from the many classification plans in use today to one industry-wide Board Class Plan. The second is the overall average rate increase.

In order to conduct an expeditious and timely public review, and acting in accordance with the Ontario Automobile Insurance Board Act, 1988, the Board retained an independent consulting firm, William M. Mercer Limited, to prepare a rate proposal for consideration by the Board. The Mercer Proposal called for an average benchmark increase of approximately 35 percent with a range of +10 and -25 percentage points. Of the proposed 35 percent increase, approximately 10 percentage points related to the expected annual trend in loss costs and 25 percentage points related to existing premium inadequacy. There was no provision for recovery by insurers of financial losses sustained in prior years.

The Board has considered carefully the evidence with respect to the overall rate level. The Board has specific concerns about the aggregate data quality, particularly data volatility. The

Board notes that Mercer did not attest to data quality and was not the source of the industry-wide data. Because of data concerns the Board modified the Mercer Proposal as follows:

1. The Board assigned a 50% weighting to each of the 1987 and 1986 accident years to recognize significant data volatility and the fact that this was the first time the Board had reviewed and considered aggregate data.
2. To mitigate the potential effects of anomalous data, the Board made a modification to the 1987 unadjusted pure premium. The 1987 pure premium has been defined by the Board to reflect a 50% - 50% weighting between (1) the actual 1987 pure premium and (2) the pure premium that would have been projected for 1987 based on a least squares fit to an exponential curve of the 9 prior years pure premium as of 12 months. This weighting gives 50 percent credence to the possibility that 1987 pure premiums as of 12 months are in fact the beginning of a trend towards increasing loss costs; and it gives 50 percent credence to the possibility that 1987 pure premiums were anomalous.
3. The Board adjusted the severity component of the annual trend estimates proposed by Mercer to reflect the changes to the 1987 unadjusted pure premium described in items 1 and 2 above. The Board also found that there was no obvious

discernible frequency trend over the long-term history, and therefore considered the frequency component of trend to be zero.

4. The Board adopted a rating period to be effective from March 15, 1989, through December 31, 1989 rather than March 14, 1990 as per Mercer. The Board intends to review rates for 1990 in the fall of 1989. This decision provides an earlier opportunity to assess the development of loss costs.
5. The Board adopted the assumption that 50% of private passenger automobile policies are 6 month policies and 50% are 12 month policies. As such, the trend period is further shortened.

The effect of the abovementioned changes to the Mercer Proposal is to reduce the proposed approximate rate level change of 35 percent to approximately 17 percent. Of the 17 percent indicated change in the average current rate level, the Board calculates that the annual loss cost trend will be approximately 7.6 percent, and that the approximately 9 percentage points beyond this figure relate to existing premium inadequacy.

Because of the impact upon consumers of both an overall rate increase and increases consequent upon implementation of the Board Class Plan, the Board has set the benchmark rates below the

actuarially indicated level of 17 percent as determined by the Board. The benchmark rates have been calculated with reference to the expected annual loss cost trend of approximately 7.6 percent. The upper limit of the range has been set with reference to the actuarially indicated figure - that, some 9 percentage points above the benchmark rates.

The Board found the treatment by Mercer of the classification differentials to be both reasonable and acceptable in light of data limitations. As such the Board accepted the Mercer estimation of the differentials, the manner of their combination and the calculation of the off-balances.

The Board found an increase in the claim and conviction surcharges proposed by Mercer to be appropriate. No industry-wide actuarially justified surcharge amounts can be calculated due to insufficient data. The Board increased by 25% the surcharges indicated by the Mercer methodology as adjusted by the Board. The resulting surcharges are somewhat higher than those originally proposed by Mercer. The claim surcharges are not dissimilar to those recommended by the Consumers' Association of Canada.

To avoid the possibility of double counting, the Board has determined that, unlike other differentials, which are to combine multiplicatively, claim and conviction surcharges should be

applied on an additive basis as proposed by Mercer and supported by the CAC. In addition, the Board has decided that, in order that drivers may understand clearly the effect of claims and convictions upon their insurance premiums, surcharges will be fixed and not subject to variation within a range.

The Board established a range of +9 to -20 percent around the benchmark rates. The upward range of +9 percentage points permits each insurer to establish its rates at the level of the industry-wide actuarially indicated rates as determined by the Board. The benchmark rates, on average, recognize the future annual trend in loss costs and are intended to permit insurers to cover the costs projected for the rating period. The range above the benchmarks allows for recognition of prior premium inadequacy (but no recovery of past losses). It also provides for operating differences among insurers arising from such matters as differences in the book of business, and gives an opportunity to earn the rate of return considered to be just and equitable. The Board expresses the view that, in the current circumstances, an allowance of 9 percentage points above the benchmark provides a reasonable recognition of such factors, without permitting individual insurers, automatically and without prior Board approval, to establish rates in excess of the actuarially indicated rate level for the average insurer. Insurers will require Board approval, following a public hearing, to increase

rates beyond 9 percentage points in excess of the Board benchmark rates.

The downward range of -20% established by the Board is intended to discourage reckless price competition and to permit insurers to adopt rates significantly below the benchmark for classes of risk that are otherwise subject to large premium increases because of classification plan changes. As well, not all companies are currently operating at or above average rate levels. The depth of the range will prevent these companies from being forced to implement unnecessary price increases in order to come within the Board-approved range. The Board will require any insurer intending to charge rates that are more than 20% below the Board benchmark rates to be subject to the prior approval process attendant upon a deviation application.

The Board's ranges are to be applied to allow insurance companies to vary composite classification rating factors and to vary base rates in any combination that produces a final premium by coverage in the range of +9% to -20% from the benchmark rates. This was the most flexible option available to the Board. Flexibility is important because, if an insurer wants to lower rates for some classes of risk but is faced with having to make that decision for all risks or no risks, the insurer may choose not to lower its rates. The Board's decision gives insurers the flexibility to lower rates to customers.

The Board determines that it does not have jurisdiction to set separate rates or rate ranges for non-standard insurers in an industry-wide hearing. The Board anticipates that non-standard insurers will apply for upward deviations from the rates and rate ranges established in this hearing.

For purposes of calculating industry-wide rates, the Board adopts a voluntary market differential of .979, based on a Facility rate differential of 2.0. The Mercer Report had recommended differentials of .989 and 1.50 respectively. These differentials more adequately reflect the relative contribution of voluntary market and Facility risks to the current average industry-wide rates. This decision produces lower voluntary market rates in recognition of the higher expected Facility rates. The Board anticipates that the Facility will not adopt the industry-wide rates and that a hearing on proposed Facility rates will be convened in the very near future. The Board will consider the Facility differential at that time for purposes of setting Facility rates. The Board has indicated that it will also consider ways to de-populate the Facility and to ensure that "clean risks" are written in the voluntary market.

Although refinements are necessary, the Board adopts the Vehicle Code Service methodology as superior to current methods of establishing vehicle rate groups. The Board will communicate

with, and monitor the work of, the VCS and will examine its methodologies thoroughly prior to the next rate hearing.

The Board states its intention to review rates and classification differentials annually. Rate hearings will be held in September, with new rates, if any, to be effective January 1.

The Board will publish comparative price information to assist consumers to comparison shop. The Board will also publish a comprehensive rate manual to assist the public to understand how insurance premiums are determined. As well, the Board will publish annually the financial results of the regulated Ontario Automobile Insurance Industry to ensure complete public disclosure.

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1. INTRODUCTION

1.1 This is the fourth part of the first industry-wide hearing (Industry-Wide Hearing) held by the Ontario Automobile Insurance Board (the Board). The purpose of this chapter is to outline in broad terms the decisions of the Board in the three prior parts of the Industry-Wide Hearing and to set out some of the major issues considered by the Board in this hearing.

1.2 The Ontario Automobile Insurance Board, created by the Ontario Automobile Insurance Board Act, 1988, S.O. 1988, c.18 (the Act), has as its primary mandate the setting, following an industry-wide hearing, of automobile insurance rates or ranges of rates that are, in the opinion of the Board, just and reasonable and not excessive or inadequate. The Board is to set a rate or range of rates for each class of risk exposure prescribed for a category of automobile insurance (the Board Class Plan).

1.3 As the Act effectively requires that a new classification and rating system be in place by June 1, 1989, it was necessary for the Board to proceed expeditiously toward the establishment of a new classification and rating plan. The Board decided, on

July 5, 1988, on its own motion, to hold this Industry-Wide Hearing under section 20(5) of the Act and to divide it into four parts.

1.4 Hearing I-88-1A established the Board Class Plan. (See Appendix A for a table illustrating the classes of risk exposure applicable to the categories of automobile insurance - personal vehicles.) The Board Class Plan applies to all companies selling regulated automobile insurance in Ontario. From the industry's perspective, all companies are to apply the same rules of classification. It is important to note that insurers still have the right to decline to write a risk. However, once a company decides to accept a risk, it must classify the risk according to the Board Class Plan and cannot subclassify according to any company plan. From the consumer's point of view, uniform rules will give consumers the opportunity to inform themselves and to make reasoned decisions when they are shopping for insurance.

1.5 Section 33 of the Act prohibits an insurer from differentiating, distinguishing, or preferring on the basis of age, sex, marital status, family status, or handicap, as of June 1, 1989. The Act therefore requires that the Board Class Plan classify risks on

bases other than those mentioned above. This is a significant change in industry practice and will affect the way the insurance industry conducts its business and the price that many insureds will pay for insurance, in some cases dramatically. There was concern expressed at the hearing and in the letters of limited intervenors about the impact of this change. This matter is discussed further in Chapter 3.

- 1.6 In Hearing I-88-1A the Board identified a need for a statistical plan to support the Board Class Plan and established the Board Statistical Plan. Data of the highest quality is very important in setting rates. The only source of data, on an industry-wide basis, was the industry itself. Data is not within the control of the Board at this time. The Board will control the data necessary for rate making only when the Board Statistical Plan becomes fully operational. Since time is a prerequisite to valid statistics, it is only with the passage of time that reliable data will be available for rate making. It is important to note that there was nothing the Board could do for purposes of this rate hearing to improve the quality of the data. (See Chapter 5.)

- 1.7 The decisions in Hearing I-88-1A are found in the Decision dated August 30, 1988 and the Supplemental Decision dated November 2, 1988.
- 1.8 Hearing I-88-1B dealt with rate making methodology. In its Decision, dated October 20, 1988, the Board adopted a methodology for the making of rates, including a uniform rating algorithm, and expressed a preference for rate ranges (where appropriate). Both the uniform rating algorithm and rate ranges will assist the consumer by facilitating comparison shopping and encouraging industry competition.
- 1.9 Hearing I-88-1C dealt with industry-wide profitability standards. The Board found that a return on equity (ROE) approach was the appropriate method to use in determining profitability, and selected underwriting margins for use in calculating the proposed rates. The Board provided for an opportunity to earn a 12.5% ROE on an industry-wide basis. For further discussion of this matter, see Chapter 3.
- 1.10 Hearing I-88-1D (the subject of this Decision) is the rate setting hearing. It has been split into two parts, rates for personal vehicles - private passenger automobile, and rates for other categories (public

vehicles, commercial vehicles, personal vehicles-other).

- 1.11 Subject to the power of the Board under section 14(2) of the Act to reconsider and to vary or revoke any decision, the rates to be set in Hearing I-88-1D are to be in accordance with the Board Class Plan established by Hearing I-88-1A; to be based on the methodology decided in Hearing I-88-1B; and to incorporate the profitability standards set out in Hearing I-88-1C.
- 1.12 One of the major considerations that the Board must bear in mind when setting automobile insurance rates under section 20 is that the resultant rates must, in the opinion of the Board, be "just and reasonable and not excessive or inadequate" (section 20(4)). The meaning of this phrase is discussed in Chapter 6.
- 1.13 In this hearing, the Board reconsidered components of the Board Class Plan with respect to the proposed rates before the Board. As it is necessary that the Board prescribe the Board Class Plan pursuant to section 29(1a) of the Act prior to the setting of rates, the Board made decisions on the issue of Board Class Plan changes before the release of this Decision. The Partial Decision I-88-1D, dated January 20, 1989,

addresses Board Class Plan changes. The Board Class Plan, limited to a large extent to personal vehicles, will be published in the Ontario Gazette on February 11, 1989. The Board Order making the regulation under section 29(1a) was issued February 1, 1989.

- 1.14 The Board herein gives its Decision and reasons for decision for Hearing I-88-1D of the Industry-Wide Hearing as it pertains to personal vehicles - private passenger automobile. A rate order will follow.

2. THE HEARING

A. NOTICE OF HEARING

2.1 The Notice of the Industry-Wide Hearing, dated July 6, 1988, was published in 16 Ontario newspapers and served on insurers. The Notice set out the four parts of the Industry-Wide Hearing and set dates for Hearings I-88-1A, I-88-1B and I-88-1C. The Board also issued a procedural order on July 6, 1988, which set out procedures for the Industry-Wide Hearing (Procedural Order - 1).

2.2 The Notice of Hearing for Hearing I-88-1D, dated November 14, 1988, was served by the Board on insurers and published in 11 Ontario newspapers. Lists of the insurers served and of the newspapers in which this Notice of Hearing was published can be found in Appendix B. The Notice set December 12, 1988 as the commencement of Hearing I-88-1D dealing with the rates for private passenger automobile insurance.

B. THE PROPOSED RATES

2.3 The Act gives the Board authority to designate a person or persons to prepare proposed rates for each class of

risk exposure being prescribed for a category of automobile insurance (section 20(8)). Under section 20(8) of the Act, the Board has a discretion as to whether to have proposed rates prepared, and by whom. The purpose of having proposed rates prepared in advance of the hearing is to ensure that there is a focus to the hearing -- a body of evidence to which all interested persons can respond. If there were no section 20(8) proposal, individual parties would be submitting proposals relating to their specific interests, and they would not be prepared in relation to each other. Further, there would be an obvious inequity if individuals were required to submit proposals, as the insurance industry, with its substantial resources and knowledge of the industry, would be at an obvious advantage over consumers.

- 2.4 The Board tendered the assignment to prepare proposed rates to six qualified property and casualty actuarial consulting firms (Transcript, at 144-45). The General Manager of the Board testified as follows (Cooke, Transcript, at 131-32):

In selecting the firms that we would tender we were ... interested in tendering to people who would have the capacity to comply with our request.

... part of our consideration was whether or not a particular firm ... would be able to provide the work in a competent manner and provide it in [a timely manner].

And so clearly, having more qualified resources that could be dedicated to this task than fewer was a positive.

There are only 38 persons with the designation of Fellow of the Casualty Actuarial Society in Canada. Of the 38 Fellows, only six or seven are with consulting firms; the remainder are employed by insurance companies.

2.5 The Board engaged William M. Mercer Limited (Mercer) to prepare the proposed rates. Mercer is an employee benefit and actuarial consulting firm. It has both actuarial experience in the property and casualty insurance industry and the necessary resources for this massive project, which had to be completed in a very short time frame. In choosing an actuarial consulting firm to prepare the rate proposal, rather than an industry or consumer organization, the Board sought, for purposes of this first rate making exercise, to commission a proposal that was independent of the interests of insurers and insureds.

2.6 Once Mercer provided its proposed rates to the Board (the Mercer Proposal, Exhibit 5.1), the Board had the

proposal published. On December 5, 1988 the Mercer Proposal was made available to the parties in the hearing and to all persons who requested a copy. Under section 20(9), the Board is required to establish a procedure to give notice to the public of the proposed rates. The Board published a special notice in 43 daily newspapers and 248 weekly newspapers. A list of the newspapers in which the Notice of the proposal was published can be found in Appendix B. The Board made copies of the proposal available without charge (section 20(8)). The Board has distributed approximately 1100 copies of the Mercer Proposal.

C. PRE-HEARING CONFERENCE

- 2.7 A Pre-Hearing Conference for Hearing I-88-1D was held on December 7, 1988. Parties and limited intervenors were invited to make submissions on matters of procedure and the issues for the hearing. A preliminary list of issues had been prepared by Board Staff. This list of issues was discussed at the Conference and issues were added or refined on the recommendations of the persons present. A second procedural order, setting out the issues and settling procedural matters, was issued on December 7, 1988 (Procedural Order - 2).

2.8 The three Notices and Procedural Orders 1 and 2 for this hearing have been included in Appendix C.

D. MAJOR ISSUES

2.9 Procedural Order - 2 sets out the issues to be addressed in Hearing I-88-1D, which include:

- . whether the proposed rates or ranges of rates are just and reasonable and not excessive or inadequate;
- . the establishment and width of the ranges;
- . the quality of the data used to set rates, including the classification differentials;
- . the place of the Facility Association and the non-standard market in the industry; and,
- . whether transitional rates (phase-in or capping) may be available for use by the Board.

E. THE HEARING

- 2.10 A panel of six members of the Board conducted Hearing I-88-1D. The Board sat full days and some evenings. The hearing commenced on December 12, 1988 and adjourned on December 22, 1988 to January 3, 1989. Procedural Order - 3, dated January 3, 1989, changed the date to January 4, 1989. The Board sat for two and one-half days in January, 1989 to hear further evidence. Argument was written, filed on Friday, January 13, 1989, with oral supplement on the same day.
- 2.11 There was a tremendous response from members of the public to the Mercer Proposal. Members of the public were invited to make their views known by writing to the Board, making an oral presentation at the hearing or by calling the Board. The letters were recorded as exhibits, the oral presentations are part of the transcript, and a list of persons who called was kept and filed as an exhibit in the hearing. See Chapter 4 for further discussion of the public participation. Lists of the parties who appeared, the limited intervenors and the witnesses are included in Appendix D.

2.12 Actuarial evidence is a necessary component of a rate hearing before this Board. Both the industry and the Facility Association were assisted by actuaries. In light of this fact, it became obvious that, for the Consumers' Association of Canada (Ontario) (CAC) to be an effective presence, it too would require expert actuarial assistance. The CAC has been funded by the Government in this regard. The actuarial witness retained by the CAC, Mr. Hunter, made a significant contribution to the hearing process. His evidence challenged the actuarial evidence of Mercer and the very limited actuarial evidence of the Industry Coalition (the Insurance Bureau of Canada (IBC); the Insurers' Advisory Organization (IAO); the Association of Canadian Insurers (ACI); and the Ontario Mutual Insurance Association).

2.13 A daily transcript was kept of the hearing. All exhibits and transcripts are available for public inspection, by arrangement with the Board Secretary, at the office of the Board located at 5 Park Home Avenue, 4th Floor, North York, Ontario, M2N 6L4.

F. CONFLICT OF INTEREST

2.14 At the commencement of the hearing there was an

allegation of a conflict of interest between Mercer and one of its sister companies, Marsh and McLennan Inc. (M. & M. Inc.). Mercer is an actuarial consulting firm and M. & M. Inc. is an insurance brokerage; both are subsidiaries of Marsh and McLennan Company (the Company). Other subsidiaries of the Company are: Putnam Companies Inc., a large money management firm; Temple, Barker and Sloan, a management and consulting firm; National Economic Research Associates, a consultant on microeconomic issues; Guy Carpenter and Company Inc., a reinsurance broker; and Marsh and McLennan Group Associates Inc., a company providing program management services for insurance and related products.

- 2.15 Mercer not only prepared the rate proposal for this hearing, but had also prepared reports for Hearings I-88-1A and I-88-1B. It had been retained by the Ministry of Financial Institutions in 1987 to prepare a report on the redistributive effects of a new automobile classification plan (Exhibit 5.5), and had attended before the Standing Committee on the Administration of Justice when it was considering Bill 2 (the Act).

- 2.16 Ms. Irene Bass, FCAS, MAAA, the Mercer witness, is a Fellow of the Casualty Actuarial Society. Once she received the designation of "Fellow", she had satisfied the academic and professional prerequisites to be a Member of the American Academy of Actuaries.
- 2.17 Ms. Bass attended at Hearings I-88-1A, I-88-1B, and I-88-1C, and qualified as an expert to give opinion evidence. No person raised any objections in any of these hearings either to Ms. Bass's qualifications, or to a potential conflict of Mercer.
- 2.18 Ms. Bass testified that Mercer, as a matter of corporate policy, operates autonomously from all the sister companies (Transcript, at 16). She also testified that she had had no contact with any of the sister companies of Mercer in relation to the assignment to propose rates (Transcript, at 34).
- 2.19 Actuaries, as self-governing professionals, are subject to a code of ethics. Ms. Bass testified that she was not in breach of this code of ethics by reason of the assignment to propose rates and any intercorporate connections (Transcript, at 32).

2.20 Parties questioned Ms. Bass on the issue of potential conflict of interest. Mr. Wizman (individual), Ms. Schaeff (individual), Mr. Kormos (NDP caucus), and Mr. Baggaley (CAC) cross-examined Ms. Bass. Only Mr. Wizman submitted that the Mercer Proposal should not be used in this hearing.

2.21 The Board, after considering the examination, cross-examination and submissions, was satisfied that a conflict of interest had not been proven. The Board accepted Ms. Bass as qualified to give evidence in the hearing (Transcript, at 63).

3. EXISTING CIRCUMSTANCES RELEVANT TO INAUGURAL RATE SETTING

A. INTRODUCTION

3.1 Two fundamental issues were before the Board in this hearing:

1. How much premium revenue should insurance companies, using industry-wide rates or rate ranges that are just and reasonable and not excessive or inadequate, be given the opportunity to generate?
2. Of the total premium revenue, how much should the companies be given the opportunity to recover from each class of risk?

3.2 In making its decisions, the Board must contend with the effects of two unique circumstances. The first affects the size of the premium revenue required industry-wide. Although the dimensions were disputed, there was general recognition of the need for a general, aggregate rate level increase caused in part by the fact that the industry was operating at inadequate rate levels at the time a rate freeze was

imposed (as of April 23, 1987), and in part by increasing loss, or claim, costs.

3.3 The second is the certain dislocation to be caused by implementation of the Board Class Plan and, in particular, the legislated removal of age, sex, marital status, family status and handicap as rating or classification variables.

3.4 In previous decisions, the Board has made reference to the abovementioned issues. The comments of the Board relating to these issues bear repetition and expansion at this time.

B. REASONS FOR EXISTING RATE INADEQUACY

3.5 As was indicated in Decision I-88-1A, the Act and the Board entered the automobile insurance scene when there were both strong upward and downward pressures on prices. These pressures have been described and analyzed in two major reports: Report of Ontario Task Force on Insurance (1986) (the Slater Report), and Report of Inquiry into Motor Vehicle Accident Compensation in Ontario (1988) (the Osborne Report).

- 3.6 As these reports outline, the property-casualty business historically has been cyclical. When rates and profits are up, companies already in the market may choose to grow and new companies may enter the market. Once the capacity to write has expanded, competition drives prices down. Eventually there is a correction to more adequate rates, and the next cycle begins.
- 3.7 In the 1980's, the cycle was exaggerated because of a particular confluence of events. Because investment yields were considerably above average, some companies took steps to write more business in order to have more money available for investment purposes; this approach is known as "cash flow underwriting". This resulted in a lowering of premiums. At the same time, however, the cost of bodily injury and property damage claims was escalating.
- 3.8 Mr. Taylor, a witness for the Insurance Brokers Association of Ontario (IBAO), described the environment as follows (Transcript, at 2682-84):

We heard this morning allusion to cash flow underwriting in a period of the early 1980s- it was certainly a period of chaos out there. Some companies acted responsibly; some companies did not. Most of the companies who did not act responsibly are no longer in business, but the situation we find ourselves in today is their legacy.

Up until 1985, when companies recognized that there was a bodily injury problem, it was a time of extremely aggressive price competition and, as an aside, I would say I don't remember anyone complaining when their premiums went down; only when they went up.

In 1985, we had the substantial rate increases coming along and that situation is exacerbated by a number of interim rate increases until rates were frozen in 1987 and the relative positions in the marketplace of all of the various insurers as of the day of the rate increase have remained unchanged except, of course, for those who took the two portions of the 4.5 rate increases ...

We thought that one of the benefits [of the creation of the OAIB] was certainly going to be that there was going to be some stability back in the marketplace, that consumers were not going to be subjected to this roller coaster ride of rates, which had been the case in the years preceding, in the early part of this decade ...

We believe the Board can bring stability to the marketplace and we expect that to be one of the major benefits of having the Board in place.

3.9 Mr. Elms, testifying on behalf of Royal, commented on the practice of cash flow underwriting (Transcript, at 1843):

... I think it would be wrong not to do it because there is a benefit from having your premiums in advance and having the opportunity to invest them and get investment returns. Cash flow underwriting is only an evil if it's overdone. If it is kept to reasonable levels to reflect the investment earnings flow of unearned premiums and loss reserves, then it's a perfectly legitimate process.

Mr. Elms testified further that he believed that cash flow underwriting by the industry as a whole was overdone in the early 1980's, perhaps because some companies felt that high interest rates (16% to 17%) would continue forever (Transcript, at 1843).

3.10 Thus, the impact of the competitive market during the 1980's was to create a climate where, knowingly or unknowingly, there was rate inadequacy on average in the market (Transcript, at 1788-89).

3.11 The Government of Ontario administratively froze rates on and after April 23, 1987. Since then, automobile insurers have been subject to "capped rates" under the Act, that is, the rate in place as of April 23, 1987. The capped rate was increased by an additional 4.5 percent, effective January 1, 1988, by virtue of a retroactive regulation made under section 29(1)(h) and (2) of the Act. The Government granted a second increase of 4.5 percent effective August 1, 1988 (Ontario Regulation 405/88).

3.12 At the time of the rate freeze in April 1987, companies were facing the prospect of significant rate increases. For example, prior to the rate freeze, it was Safeco's intention to continue a pattern of semi-

annual increases of approximately 10 percent until it achieved rate adequacy. Four rate increases at 10 percent compounded approximates 41.5 percent (Transcript, at 1696-99).

3.13 The market conditions described above have affected consumers significantly in various ways. Insurers have become more selective about the persons they insure in an attempt to lower the number and severity of claims by choosing insureds with lower risk profiles. The cost of automobile insurance has increased overall, but especially for higher risk insureds. Many consumers have found it difficult to purchase automobile insurance from the standard insurers. A relatively small number of companies (the non-standard insurers) do insure drivers who are generally considered to be a higher risk if these drivers meet their applicable underwriting criteria. Because automobile insurance is compulsory in Ontario, motor vehicle owners who could not otherwise purchase insurance have had to resort to the Facility Association. (See Chapters 11 and 12 for a further discussion of the Facility Association and non-standard insurers.)

- 3.14 The Mercer Proposal recommended base rates for 1989 which, on average, amounted to an increase in cost to the consumer of 35 percent compared to 1988. Mercer indicated that approximately 10 percent of the total change related to anticipated annual changes in loss costs projected to the prospective rating period, and approximately 25 percent related to a correction for prior rate inadequacy (Exhibit 5.1, at 2).
- 3.15 Rates are set prospectively and no part of this proposed 35 percent increase related to recovery of "bottom line" losses in completed financial years on private passenger automobile lines (Transcript, at 231-33). The Mercer Proposal provided for a prospective increase, which included, according to the Board methodology, an implicit ROE of 12.5 percent as determined by the Board in Decision I-88-1C for 1989. The Mercer Proposal provided only for a prospective increase, giving an opportunity to earn a fair return in the future.
- 3.16 Ms. Bass testified that the opportunity to earn a 12.5 percent ROE, on average, would not realistically exist until calendar year 1991. It would take that long for prior inadequate rates to work through the system. New, adequate rates would be in place only for new and

renewal business written during the twelve months following June 1, 1989 (Transcript, at 3308-09).

C. COSTS AND THE OVERALL RATE CHANGE

1. Claim Costs

3.17 The overall rate level change is driven principally by claim or loss costs. Insurance, in simple terms, is a pool from which to pay losses arising from the conduct and misfortune of all drivers (Transcript, at 100-04). If the losses go up, the rates will go up and all drivers will pay more. The public must be satisfied that the estimates of losses relied upon to set rates for the future are accurate and that the methods used to analyze the data are realistic. Time and experience are all on the public side. As Board Counsel commented, insurance is now firmly fixed as an issue to be decided in the public domain and in the public interest.

3.18 Some costs are external to insurance companies, while others are internal. Each type of cost was considered in Decision I-88-1C, and Decision I-88-1B determined how each cost is to be treated in the rate making methodology. In this hearing, the Board heard some

evidence on ways to reduce costs. Tort reform and no-fault schemes are attempts to address costs (claims and adjustment expenses) that largely are external to insurance companies; they are sought by the industry because it believes a solution to the problem of loss costs is to change the product (Transcript, at 1974-75). Efficiency -- administrative, operational and financial -- is internal to the system. This matter was considered in Hearing I-88-1C and will be closely analyzed in subsequent industry-wide hearings, as well as in company-specific deviation hearings.

3.19 The Board heard in this hearing from advocates of public insurance, including the New Democratic Party. It was submitted to the Board that public insurance would reduce the cost of insurance. Board Counsel indicated (Submission, at 1/19) that, to the extent that loss costs are driving the need for premium increases, this would not likely change with public insurance. He stated that there is no evidence to suggest that loss costs are a function of ownership.

3.20 There was some support for no-fault insurance expressed by members of both the industry and the public giving evidence before the Board. Board Counsel invited the Board to note (Submission, at 1/19) that under a no-

fault option, settlement in long-tail lines would be made more quickly and, as a result, investment income would decrease. To the extent that benefit levels change under a no-fault scheme, the consumer receives a different package of benefits. Moreover, administration costs could increase, particularly if two product options, fault and no-fault, were to co-exist. Evidence on behalf of the CAC indicated that no-fault options are unlikely to save money, although they may be meritorious for other public policy reasons (Transcript, at 3612).

- 3.21 The Board has indicated that, as part of the next industry-wide rate hearing to be conducted in 1989, it will consider the measures available to reduce the frequency and severity of automobile accidents and to control automobile insurance loss costs in the best interests of insurers and consumers. All the evidence in this Industry-Wide Hearing on these issues will be read into that hearing.

2. Profitability

- 3.22 The Board in Hearing I-88-1C considered whether, and to what extent, the proposed rates for consideration at

this hearing should incorporate a provision for "profit", which became known as the "underwriting margin". The Board adopted a total return approach for the industry and selected a model which includes both underwriting income and investment income. Thus, all insurer sources of income have been taken into account. One of the assumptions adopted is that policyholders are entitled to be given credit for the investment income earned by the insurer on the funds paid to the insurer as premium. This assumption, when combined with others (including the opportunity to earn a 12.5% ROE) in fact produced underwriting margins for 1989 that are negative. As a result, charges that insurance companies are allowed to "pocket" investment income earned on policyholders' funds simply do not reflect the methodology adopted and used by the Board.

- 3.23 The rate setting exercise, by definition, requires the pricing today of a product whose true costs are not known until some years after all claims are settled and closed. As such, the pricing and reserving decisions are highly dependent on judgment. A simple review of one year's financial results does little to assist in a comprehensive understanding of the true financial health of the industry. This is one of the reasons why the Board, in Decision I-88-1C, indicated

its intent to refine further the Board's Financial Reporting Package to allow for a more complete reconciliation of financial reporting and rate making results.

D. CHANGES IN CLASSIFICATION AND DISLOCATION

3.24 In Decision I-88-1A, the Board observed that the generally recognized function of a classification plan for the purpose of setting rates is to establish classes of insured persons exhibiting similar risk characteristics that will reflect the degree of risk presented by members of the class.

3.25 A classification plan may also incorporate social judgments; for example, differentiation on the basis of such characteristics as age, sex or marital status may be deemed to be so unacceptable as to be prohibited, even if such differentiation can be justified by statistical evidence. The classification plan adopted by the Board in Hearing I-88-1A incorporates such judgments. This was required by the Act, as section 33, which comes into force on June 1, 1989, prohibits differentiation on the basis of age, sex, marital status, family status or handicap.

3.26 Age and sex are fundamental to the classification and rating systems employed by the insurance industry today. The removal of age, sex, marital status, family status and handicap as classification and rating factors is the major source of the dislocation that will be experienced as a result of the implementation of the Board Class Plan. The changes were supported not only by the Government, but also by the current Official Opposition. Evidence as to the potential dislocation was presented to the Standing Committee on the Administration of Justice by Mercer (Exhibit 5.5) prior to the passage of the Act and the establishment of the Board. As such, the current dislocation is not unanticipated; it derives from the legislative desire to remove these types of discrimination from the classification systems currently used by insurers.

3.27 Other factors will contribute to dislocation. The many classification schemes in place today will be replaced, as of June 1, 1989, by a uniform scheme, the Board Class Plan. Moreover, the existing market for insurance contains rates for similar products that differ by as much as 130 percent (Decision I-88-1C, at 37); the implementation of uniform Board-set rates (within a range) will give rise to some further degree of dislocation. Both these influences, however, are

small compared to the effect of the legislative changes removing the discriminatory factors.

- 3.28 It should be noted that the rate changes arising from the Act and the implementation of the Board Class Plan are a one time change. Although the Board has determined that an industry-wide hearing should be held during 1989 to provide a forum for consideration of future amendments to and refinements of the Board Class Plan, the Board is mindful of the cost and confusion attendant upon any changes to the Board Class Plan and has indicated that it will not effect such changes lightly.

E. CONCLUSION

- 3.29 In reaching the conclusions incorporated in this Decision, the Board has been very mindful of the particular circumstances prevailing in the first year of industry-wide rate setting. The Board has considered, wherever possible, approaches to assist in ameliorating the transition from an unregulated to a regulated environment. The use of rate ranges, as prescribed by Decision I-88-1B, has given the Board opportunity to allow a competitive market place to continue and, with the uniformity inherent in the

methodology and the new types of information to be provided to consumers, competition will gradually be enhanced in positive ways. Because, for the most part, the Board has opted for rate ranges, the companies, through the selection of respective points within the range, will ultimately determine the total revenue to be collected, within the limits of the range. One of the goals of regulation by this Board is to bring discipline to rates over time by controlling wide swings in the pricing of insurance. Practices such as excessive cash flow underwriting, followed by a dramatic increase in prices as insurers try to catch up for past rate inadequacy, will not be countenanced.

4. THE PUBLIC

A. INTRODUCTION

- 4.1 Public input is an essential part of the public hearing process. There are statutory provisions in the Act which provide for public participation in the Board's hearing process.
- 4.2 The Board is to give public notice of its hearings (section 11(2)) and is required to give notice to the public of proposed rates or ranges of rates in the industry-wide hearing (section 20(9)). The Notice of Hearing, dated November 14, 1988, was served on parties known to the Board and all insurers and was published in newspapers in Ontario. The Notice of the Mercer Proposal was published in a number of both daily and weekly newspapers. See Appendix B for a list of the newspapers in which these notices were published. Copies of the proposal were made available to members of the public on request.
- 4.3 The Board received over 2,700 telephone calls from members of the public. Exhibits 3.403 and 3.403(a) contain a list of the concerns raised during these telephone conversations.

- 4.4 The Board received 386 written submissions. These submissions are contained in Exhibits 3.1 to 3.433. See Appendix D for a list of persons who made written submissions.
- 4.5 Twenty-two petitions were received by the Board. These petitions contain approximately 65,250 signatures. This includes the petition submitted by Ms. Schaeff, which contained 63,457 signatures. See Appendix D for a list of petitions filed.
- 4.6 The Board acknowledges the extraordinary efforts of Ms. Schaeff in conducting a province-wide petition campaign to oppose higher automobile insurance rates and in participating as a party at the hearing. Ms. Schaeff was able to focus the views expressed by many motorists across the Province.
- 4.7 The Board notes that on January 17, 1989, Mr. Reycraft, MPP, Middlesex, presented a petition addressed to the Honourable Lieutenant Governor and the Legislature of Ontario. The petition was signed by 1,113 residents of the riding of Dufferin-Peel. (Hansard: January 17, 1989, at 7353).

4.8 Throughout the hearing, members of the public made oral presentations before the Board as limited intervenors. All members of the public who wished to make oral submissions were accommodated by the Board. In addition to these ad hoc arrangements, the Board reserved two evening sessions and a morning session for members of the public. In total, 55 individuals appeared before the Board during the public hearing. See Appendix D for a list of persons who made oral submissions.

4.9 Notwithstanding the above, the Board received comments from some members of the public stating that they were disappointed with the timing and location of the hearing. Some individuals stated that they were inconvenienced because the hearing was scheduled during the holiday season. Some persons would have preferred that the Board hold hearings throughout the Province.

B. GENERAL IMPRESSIONS

4.10 Most of the public comment received by the Board can be categorized under eight headings: the Mercer Proposal; the operation of the Board Class Plan; loss costs and cost control; the profitability of insurers and the Board's decision to permit automobile insurance

companies an ROE of 12.5%; the affordability of insurance premiums; the possible economic impact of a large rate increase; an appropriate rate increase; and the role of insurance brokers. These issues will be discussed below.

4.11 A review of the comments suggests a general lack of understanding of the insurance industry as a whole and, in particular, the automobile insurance industry. For example, many comments attributed the large real estate holdings of the life insurance industry to the automobile insurance industry. Some persons did not appear to understand the role loss costs play in determining insurance premiums. Many persons simply blamed the insurance industry for the present situation and the proposed rate increase.

4.12 The comments received also indicate that the public is not aware of the legislative steps initiated by the Government to prohibit the use of age, sex, marital status, family status and handicap as rating criteria. Many comments indicated strong support for the old rating methods, and assumed that it was the Board, rather than the Legislature, that was responsible for the changes. The elimination of the discount for persons over 65 years of age was clearly referenced.

C. THE MERCER PROPOSAL

- 4.13 Approximately 500 copies of the Mercer Proposal and 200 copies of the executive summary were forwarded to members of the public. The public found the contents of the proposal to be complex and difficult to comprehend. Others suggested that the time span between the release of the proposal and the commencement of the hearing should have been greater than one week so as to enable a thorough study of the proposal. Generally, the public expressed outrage at the recommendation to increase average automobile insurance rates by 35 percent. In addition, some people commented on the perceived conflict of interest between Mercer and one of its sister companies, Marsh and McLennan Inc.
- 4.14 Many comments were received about the quality of the data. There was media attention on the data quality issue when it was discovered that OHIP payments by insurers had been double counted. Some people were under the mistaken impression that the data problems were the fault of Mercer. Others stated that the Board should not use insurance industry data, as it is self-

serving and tainted. The data issues are discussed in some depth in Chapter 5.

D. CLASSIFICATION SYSTEM

4.15 The Board notes that there was considerable concern expressed about the rating criteria contained in the new Board classification system and how it will influence the premium level. The dislocation that will result from the implementation of the new Board Class Plan, particularly as a result of the elimination of age and sex as rating criteria, is perceived to be unfair because it will be too drastic and will occur too suddenly.

4.16 There was a widely held belief that the rating criteria used in the Board Class Plan will penalize motorists with long-time "clean" records, while poor risks, such as persons with recent drunk driving convictions, will pay proportionately less. Those with "clean" records believed that they will be absorbing more than their fair share of the premium increase. A very clear punitive attitude towards drivers with claims and convictions was evident. The view was expressed that such drivers should be surcharged heavily, without apparent regard to whether

the result would be that insurance would be unaffordable for such drivers.

4.17 There were many comments critical of the Board Class Plan. For example, experienced drivers claimed that the Board Class Plan is unfair because it will not recognize their driving experience beyond 6 years. Suggestions were made that the experience variable should recognize drivers with 10 years driving experience or more.

4.18 The territory class of risk exposure was also the subject of many comments. Some individuals expressed concern about how the territorial indicator will influence their premiums. Rural residents believed that they should not pay as high a premium as those who reside in urban or metropolitan areas. Residents of border communities, such as Fort Erie, Niagara Falls, Sarnia and Windsor, were of the view that their premiums were too high. Windsor residents, in particular, felt that they suffered an undue penalty by reason of their proximity to Detroit.

4.19 Several motorists stated that, under the present rating criteria, premiums did not reflect depreciation in the value of their car. Suggestions were made that the

Board Class Plan should consider factors such as the model year of the car, its current value, and its relative repairability.

4.20 A review of the comments received on the Board Class Plan indicates some confusion about how convictions would influence the premium to be paid. There was considerable comment suggesting that the conviction rating factor should operate to "weed out" the poor risks by pricing insurance out of their reach. Others pointed out that this approach would not be successful because many drivers would then simply drive without insurance coverage.

4.21 The influence of claims history on premiums gave rise to a number of comments from members of the public. Many stated that the Board Class Plan should distinguish between large and small payouts, and that the size of any surcharge should vary with the size of the amount paid out by the insurer. In addition, concern was expressed that classification does not distinguish between at fault and no fault claims. The indication was that persons who are at fault should be surcharged.

- 4.22 Several persons who stated that they were "clean risks" and that they had been placed in the Facility Association commented on the harshness of the rating process. Some individuals said that they were placed in the Facility simply because they had allowed their coverage to lapse. They were angry because the insurer did not appear to give consideration to their claim-free and conviction-free history. Some believed that insurers had a direct incentive to place "clean risks" in the Facility to maximize overall revenues.
- 4.23 Other comments were received suggesting that the Board Class Plan should surcharge smokers and those with cellular telephones, as they may be distracted by these activities and cause an accident.
- 4.24 Comments were also received recommending that a wider range of deductibles should be available to provide greater flexibility in rates.
- 4.25 Many senior citizens believed that they should be entitled to a lower premium because their annual driving distance is very low.
- 4.26 Many were optimistic that the new Board Class Plan will look upon them more favourably. However, some

persons were concerned that, although automobile insurance is compulsory in Ontario, there is no corresponding requirement that an insurance company must provide coverage.

E. LOSS COSTS

4.27 The issue of loss costs was certainly on the minds of many individuals who contacted the Board during the hearing. Some criticized the Board for its approach to rate making. They suggested that the Board should first have investigated whether loss costs are inflated by surcharges and commissions made throughout the auto collision and towing industry, and by selfish plaintiffs in automobile-related personal injury actions. If the Board could identify specific areas where loss costs were inflated, it could then adjust loss cost trends downwards. It was believed that this approach would have resulted in relatively lower premiums.

4.28 In general, the comments received on loss costs could be categorized into five main themes. First there were observations made on automobile repairs. A two-tier pricing practice was alleged. If an insurance company was involved, the repair estimate would be

substantially higher. Many persons recommended that the Board investigate this practice. Others believed that insurance companies deserve some blame for failing to investigate, and thus countenancing, the practice. Other persons remarked on the exorbitant price of replacement parts.

4.29 The second theme concerned the actions of tow truck operators. Some people stated that towing costs appear to be inflated and should be regulated. Others gave examples of incidents suggesting collusion between towing operations and body shops.

4.30 The third theme centred on the cost of settling claims. Some comments expressed outrage at the size of personal injury settlements and judgments awarded by the courts. Other comments focused on the costs of settling claims and costs generated by the legal profession and adjusters.

4.31 Another concern expressed was that many fraudulent claims are paid unnecessarily by insurance companies. Other persons referred to intimidating tactics used by insurance adjusters in situations where the automobile has been "written-off". These persons felt cheated because the insurance company was unwilling to restore

them to the position they would have been in had the accident not occurred.

4.32 The fourth area focused on automobile design. Many people would like to see automobile insurance companies use their "clout" to influence automobile companies to design automobiles that are safer, resistant to minor collisions, and more easily repaired using inexpensive replacement parts.

4.33 The fifth theme addressed preventative steps that could be implemented to reduce loss costs, including more rigorous and frequent driver testing and regular vehicle inspection. The timing of vehicle licence renewal to coincide with insurance renewal, as well as more police enforcement to weed out uninsured motorists and a more punitive licence demerit point system, are some of the other suggestions that were made. The Board also heard thoughtful presentations and comments recommending changes to road design and signing to promote safety.

4.34 There was a general impression that loss costs are out of control. In addition, many believed that insurance companies currently do not have any incentive to reduce or control loss costs. There was a general desire

expressed that insurance companies take the initiative to reduce loss costs. There was also thought to be a need for no-fault insurance legislation or public insurance, or caps on payouts by insurers.

F. PROFITABILITY

4.35 The comments received on industry profitability were generally negative. Most people believe that the automobile insurance industry is profitable. Others suggested that insurers have been cross-subsidizing automobile insurance revenues through their other lines of business. The Board also received comments suggesting that the Board undertake a full scale independent audit of automobile insurance companies. The Board's decision in Hearing I-88-1C permitting insurers an opportunity to earn a 12.5% ROE was generally misunderstood. Many persons were under the mistaken impression that the Board had guaranteed automobile insurance companies a 12.5% profit.

G. AFFORDABILITY

4.36 The recommendations contained in the Mercer Proposal generated considerable public comment on the issue of affordability. Many comments suggested that ordinary

citizens could not absorb such an increase in their premiums.

4.37 A significant proportion of the comments on affordability came from senior citizens, other individuals on fixed incomes, or those with low incomes. These individuals stated that a large increase in their premiums would create hardship. Many feared that the premium increase would place the cost of operating a vehicle beyond their means.

4.38 For many senior citizens, the automobile provides a sense of independence. For persons residing in rural or remote areas of the Province, the automobile is absolutely essential. Usually there is no reliable alternative, such as public transportation, to convey these persons to their workplaces. The Board also received comments from individuals who require a vehicle because they, or members of their family, are disabled or require frequent medical attention. Youthful drivers remarked that premiums in the \$2,000. range place a car beyond their reach.

4.39 There appears to be an expectation that, if insurance rates increase substantially or if premiums are no longer affordable, motorists will reduce their

coverage below a desirable level. Some indicated that they will simply drive without insurance and face the consequences if they are discovered by police. There was also concern expressed that if this rate making decision encourages people to drive without insurance, there will be less money available to pay claims than under the old system.

H. ECONOMIC IMPACT

4.40 The Board received many forecasts concerning the economic impact of a large rate increase. It was believed that a large rate increase will influence many individuals to sell their car, or second car. This will create a glut of used cars and new car sales will also plummet. People will travel less by car. This will have a negative influence on gasoline sales and auto repairs. Others suggested that public transit systems will become overburdened. Some persons predicted that the reduction in consumption of automobile-related products and services will ripple through the economy.

I. RATE RECOMMENDATIONS

4.41 Most people stated emphatically that they were opposed

to any rate increase. However, if the Board were to grant an increase, many persons preferred an increase in line with the rate of inflation. An increase above the rate of inflation and up to 10 percent would be tolerated by some individuals. Others suggested that the Board should decrease rates.

J. INSURANCE BROKERS

4.42 The Board received several comments on the role of insurance brokers. Some individuals provided anecdotes of their unfavourable dealings with insurance brokers. They concluded that brokers may have an incentive to place their own self-interest before the interests of their clients. It was suggested, for example, that, in deciding whether to place business with an insurance company, brokers may be motivated by a desire to meet a quota rather than by a desire to obtain the lowest possible premium for their clients.

4.43 Several comments were received about the commission arrangements between insurance companies and their brokers. Some persons suggested that the commissions are too high compared with the level of service provided, and that this matter should be investigated by the Board.

4.44 Many individuals commented that, under the present arrangement, it is difficult to understand how the premium is calculated. This made comparison shopping almost impossible. Members of the public also exhibited the mistaken belief that insurance brokers explore the entire industry to quote the best rate. It was suggested that the Board, or insurance companies, prepare a buyers' guide to explain the role of insurance brokers and how premiums are determined. Some believed that some type of insurance Ombudsman would be helpful in disseminating public information, responding to inquiries and resolving complaints.

K. BOARD COMMENTS ON PUBLIC INPUT

4.45 The Board wishes to express its gratitude to those who took the time to make their comments known. The Board has found these comments to be invaluable. Since this Decision will affect millions of private passenger vehicle owners through the premiums they will pay, the Board has considered carefully the comments that were received from members of the public.

4.46 The Board understands the frustration experienced by the public in comprehending the Mercer Proposal. The

Mercer Proposal is a complex actuarial document. It is the Board's hope that participation by the public in future hearings will contribute to a better understanding of the rate making process, and of the role of the actuarial rate proposal as but one element in that process.

4.47 The Board Class Plan is not cast in stone. The Board will address problems experienced with the Board Class Plan in a future industry-wide hearing. This hearing will be held at various locations throughout the Province. Members of the public will be invited to express their views on the classification system at that time.

4.48 The Board will hold a public hearing to address the issue of loss costs in the near future. Public comment received during this hearing will be introduced as evidence and will be considered once again at the hearing on loss costs.

4.49 The Board received many interesting suggestions concerning how loss costs could be prevented or reduced. Some of the suggestions require the attention of other government ministries. The Board will forward suggestions relating to automobile body shop and towing

charges to the Minister of Consumer and Commercial Relations. The suggestions on claim settlements and judgments will be forwarded to the Attorney General. The suggestions for improvement of road design and signing will be sent to the Minister of Transportation. It is the hope of the Board that the comments from the public detailed in this Chapter will be noted and considered carefully.

4.50 The Board will strive to ensure that the public has a better understanding of the insurance rate regulation process. The Board plans to take a number of initiatives relating to consumer information (see Chapter 13).

4.51 The Board appreciates the public comment received, as it provided an important perspective in the hearing process. Indeed, it was an essential element in the balancing process, as the Board weighed its mandate to set rates that are "just and reasonable and not excessive or inadequate".

5. DATA USED IN CALCULATING PROPOSED RATES

A. INTRODUCTION

5.1 The Act (section 20(1)) directs the Board to set a rate or range of rates with respect to each class of risk exposure for a category of automobile insurance that has been prescribed in the regulation made by order of the Board (sections 19 and 29(1a), to be published in the Ontario Gazette on February 11, 1989 as the "Classification Plan."). The hearing and this Decision pertain only to private passenger automobiles, which are included in the category of personal vehicle. This term is defined to mean:

... a motor vehicle classified as pleasure use, commute use, business use or farm use and does not include a motor vehicle that has a gross vehicle weight of more than 4500 kilograms (10,000 pounds).

5.2 The classes of risk exposure to be used in respect of private passenger automobile are:

- . territory
- . vehicle use
- . annual driving distance
- . years licensed (principal driver and secondary driver(s), including driver training)
- . make, model and model year (vehicle rate group)

- . abstinence
- . number of vehicles
- . conviction history
- . vehicle claim history

5.3 Rates are calculated with reference to the coverage limit and coverage deductible classes available with respect to a particular category of insurance. The Board will regulate certain coverages, set out in the Classification Plan, and therefore rates must be established for the following:

Third Party Liability (Bodily Injury and
Property Damage)
Accident Benefits
Comprehensive
Collision
Specified Perils
All Perils

The Board is also regulating SEF 44, and therefore rates must be established for this endorsement.

5.4 Rate making methodology was the subject of the second part of the Industry-Wide Hearing and the application of the methodology adopted, as well as methodology issues deferred to this hearing or new issues raised in this hearing, are considered in detail in Chapters 6 to 9, inclusive, of this Decision. A very basic understanding of that methodology, however, is essential if the evidence with respect to the underlying data is to be adequately understood.

Although the methodology for other personal vehicles and commercial and public vehicles will be very similar, it must be remembered throughout this Decision that the scope is confined to private passenger automobiles. The methodology will be reviewed in Chapter 6, and applied or modified in accordance with the decisions of the Board in this hearing. This overview is provided as background information to consideration of the data used in the rate proposal.

- 5.5 The first step is the calculation, by coverage, of the average adjusted pure premium for Ontario for the prospective period for which rates are being made. The overall purpose of this step is the quantification of how much money has to be available in Ontario to pay the claims or losses, including the expenses directly attributable to adjusting those claims or losses, which will arise from accidents occurring in that period. In trite terms, the "size of the pie" needed to pay claims arising from accidents that have occurred and will occur in 1989 is being determined. The starting point is the calculation of the unadjusted pure premium for the prior periods. The unadjusted pure premium constitutes an historical foundation, and then that amount is projected into the future period to produce an average adjusted pure premium through the

application of various factors (that is, development, trend, catastrophe, unallocated adjustment loss or claim expense and rate group drift).

5.6 The second step is the distribution, by the classes of risk exposure relevant to each coverage, of the average adjusted pure premium for Ontario. Whereas the average adjusted pure premium is a dollar amount, the distribution is achieved through the selection of differentials by class (factors and additive dollar amounts), applied to the adjusted pure premium for each coverage. Again, in trite terms, in this step the pie is being divided into pieces according to the risk characteristics or profile of insureds. The rate is calculated through the use of a rating algorithm that is specific to each coverage.

5.7 The third step is the determination of the expected operating costs associated with automobile insurance, some of which vary according to premium, and some of which vary on a per exposure basis. Premium variable expenses include premium tax, provision for OHIP, acquisition expenses and the underwriting margin. These are included by means of a factor applied to the pure premium by coverage. In the methodology of the Board, these costs are captured in a uniform dollar

amount to be applied to each premium, that is, an expense constant. It must be remembered that both allocated and unallocated claims expenses are included in the calculation of the average adjusted pure premium and therefore should not be included in the expense constant.

5.8 Rates are the result of methodology applied to data. This Chapter will consider the overall issues relating to the data used by Mercer in calculating the average adjusted pure premium for Ontario and the differentials by class.

5.9 The data used in selecting the premium variable expenses and the expense constant will be considered in Chapter 6. The rating algorithms are based on a selection of the mathematical relationships between these items and therefore they do not raise, per se, any issues relating to data.

B. IMPORTANCE OF DATA

5.10 The regulatory scheme for automobile insurance rates in Ontario is founded solely on the provisions of the Act. One of the principal themes of the Act is uniformity in the key areas of risk classification and industry-wide

rate making. Regulation has been superimposed on an industry and a market place characterized by free market prerogatives at the company level, tempered by competition. It has been an industry diverse in classification and rate making, with the result that there is a significant mismatch between the types and characteristics of data that are useful in the old environment, and those that are essential in the new environment.

- 5.11 The Board, in each part of the Industry-Wide Hearing, has considered both existing data and new data needs at considerable length (Decision I-88-1A, Chapter 7; Decision I-88-1C, at 258-62).
- 5.12 The Board, in Decision I-88-1B, referred to both "the severe data restraints to which [the Board] is subject" (at 14) and "the short time frame within which such rates must be established" (at 12). The unavailability of data was one of the major reasons supporting the adoption of interim methodologies for rate making, compared to the ultimate methodologies that the Board selected for implementation. The Board determined (at 15):

1. For purposes of rate making in the interim period, prior to data being

available under the Board Statistical Plan, the Board will have recourse to collateral sources of information, including data from foreign jurisdictions.

2. Reliance will be placed on Ontario data to the extent possible. Moreover, the use of collateral data will be fully disclosed, supported and documented at the time rates are proposed, and will be subject to testing in Hearing No. 4 and at industry-wide rate hearings in subsequent years.

5.13 Specific issues pertaining to data in the future operations and deliberations of the Board will be discussed throughout this Chapter. It may be useful, however, in order to give some perspective on the data utilized by Mercer, to comment on two overarching matters, that is, the data chain and the time frame for developing data.

5.14 It is overly simplistic to state that all data required by the Board originates from insurance companies, although for obvious reasons most of it does. The representatives of the IBC and the IAO who constituted a panel and gave evidence in this hearing on data provided by those organizations to Mercer noted correctly that some information, particularly with respect to the classes of risk exposure listed in paragraph 5.2 above, comes to an insurance company from an applicant for insurance (whether new or renewal),

and/or from the broker or agent selected by the applicant (Exhibit 11.3, opening chart; Decision I-88-1A, paragraph 7.2). Some of this information is verifiable at (arguably) reasonable cost through other sources (for example, driver convictions for the most recent three years are available from the Ministry of Transportation of Ontario at a standard fee). Other information is not easily or affordably verifiable (for example, annual driving distance, vehicle use, abstinence). The industry currently is addressing claim experience through the development of a claims tracking system, although it has not yet been implemented (Decision I-88-1A, paragraph 7.29).

- 5.15 While it may be argued that insurance companies should take additional steps beyond those currently in use in order to improve the accuracy of the information they receive as part of the underwriting process, nevertheless individual insureds, brokers and agents must accept responsibility for ensuring that accurate information enters the system. Inaccurate information at the entry level increases costs to all insureds, both because money must be expended on verification and because the setting of a premium that is neither too high nor too low given a person's risk profile will be frustrated.

5.16 It is unrealistic to assume that, once a data need is identified, the required data can be produced quickly, and that it is immediately reliable and meaningful. Quite apart from the time it takes to alter the collection and data processing systems appropriately, it takes time to ensure that the data meets the basic standards of completeness, accuracy and validity. There is a transition period of relatively short duration associated with every major change, whether company-wide or industry-wide (Transcript, at 1272-73).

5.17 Furthermore, even when data that meets the basic standards becomes available, it may take several years of studying and configuring the data before real confidence in the conclusions based on the data can be taken. Ms. Bass commented in cross-examination on the importance of experience with the data to the overall result (Transcript, at 590-91):

Q. But you do agree, though, that for each year that actual number [for surcharges]; if it's a set number that's picked, that has to be reviewed if for no other reason than inflation?

A. I agree very strongly that all of these numbers have to be reviewed. It is especially important in these early years where we are going from right now the most uncertainty that we have because we have so little data available, especially with

respect to the classifications, and we are going to move and gradually increase the amount of experience. Next year we will have some information, but not nearly enough ; the second year, and so forth. So I would say in the initial five years it's going to be very critical to revisit everything.

Afterwards, it may -- you may not adjust everything every year. You may keep -- for example, the territorial relativities may not change much from year to year. You may only look at those every two or three years, but, yes, you have to revisit them periodically.

It may be that it will take at least two to three years before the Board can cease to regard itself as being in an interim period with respect to methodology and data (see, for example, Transcript, at 390).

5.18 The only source of aggregate data for the Ontario automobile insurance industry (OAI) is the data which has been collected in accordance with the Automobile Statistical Plan (Stat Plan) of the Superintendent of Insurance of Ontario established pursuant to statutory authority (Transcript, at 109, 286). Statistics Canada, for instance, does not report insurance data by province (Transcript, at 956). The Stat Plan, in fact, is uniform across the provinces for all automobile business excluding the government plans and it is overseen by the Canadian Council of Superintendents of Insurance. IBC is the agent of the Superintendents with respect to the Stat Plan. IBC, a national

association of general insurance companies in which membership is voluntary, also collects some data from its members, as does the IAO.

5.19 The Board appreciated the importance of data to the evidence to be heard in this hearing, to the decision of the Board and to public confidence in that evidence and decision. All requests for data were made, on behalf of the Board, by Board Staff, and were based on the requests of Mercer to the Board. All responses constitute part of the files of the Board, which are accessible to the public (Transcript, at 286-87, 297-98, 304-05). The responses from IBC and IAO are voluminous (Exhibits 5.2 (a) to (t)).

5.20 The data received by the Board was transmitted to Mercer in its entirety, without alteration (Transcript, at 305). Mercer then used the data in accordance with the interim methodology adopted by the Board, subject to changes in that methodology proposed by Mercer in this hearing based on the limitations of the data. Overall, the Board is of the view that Mercer complied admirably with the directions of the Board with respect to data, quoted in paragraph 5.12 above. In particular, Mercer scrupulously disclosed, supported

and documented problems with the Ontario data as well as the use of collateral data.

5.21 Scrutiny of the data and its application occurred at two levels. The first level was general, in that it was argued that, taken overall (in the calculation of average adjusted pure premium, the differentials by class and the expense constant), there are sufficient doubts about the completeness, accuracy and validity of the data to justify a moderation of the overall estimated rate increase. This view was put in the final argument of the CAC as follows (at 23) and was supported by the analysis of Mr. Hunter, which will be discussed below:

CAC is obviously concerned about the accuracy and the completeness of data used by Mercer. Our concerns are heightened by the large overall increase recommended by Mercer and by the impact on certain groups of drivers resulting from changes to the classification system. The soundness of Mercer's recommendations are dependent upon the quality and completeness of the data. The data problems that have been identified should make the Board cautious about raising premiums to a level that will make insurance unaffordable for some drivers, or about approving high classification differentials that will result in dramatic rate increases for certain groups of drivers.

Parties to this hearing also made specific arguments with respect to the actual data used in applications of

all parts of interim Board methodology and the resulting effect on the rates produced. These arguments will be addressed in Chapters 6 and 7.

C. DATA BASED ON THE STAT PLAN

5.22 Since 1930, the Insurance Act, R.S.O. 1980, c.218, has required that every licensed insurer carrying on the business of automobile insurance prepare and file with the Superintendent of Insurance (the Superintendent), or with a statistical agency designated by the Superintendent, a statistical return in the form and format required by the Superintendent (section 80). Other provinces adopted the same approach of a compulsory plan, with the result that a uniform Stat Plan has been in place in all provinces since January 1, 1937 (although the current Stat Plan excludes business written by public insurance corporations in the provinces of British Columbia, Manitoba, Quebec and Saskatchewan). Companies are required to report all transactions occurring within a month not later than 30 days after the close of the month. Selected parts of the data, segregated by province, are published annually (in April for the preceding calendar year) in a volume entitled "Automobile Insurance Experience" (the Green Book). Data relating to the Facility

Association is included in a similar volume for comparable organizations (the Grey Book). Also, IBC publishes semi-annually the "Automobile Accident Half Year Statistical Exhibit" (described in Exhibit 11.2).

5.23 The Superintendent has never collected, processed and published the statistical returns directly. The IBC and its predecessor have been the statistical agency since 1930. The evidence suggests that this relationship between the Superintendent and the IBC is not governed by any written agreement (Transcript, at 1307-08), apart from the "Plan Application" portion of the Stat Plan itself which also governs the compliance standards to which the companies are subject.

5.24 The Stat Plan adopted by the Superintendent pursuant to broad statutory power prescribes not only what information must be submitted, but also the record format to be used (Transcript, at 958). There are two record formats -- premiums and losses or claims-- which include a number of information fields. To some extent, these two formats are mirror images because both formats contain fields organized by coverage and by classification. Approximately 16 million records are put in the Stat Plan annually (Transcript, at 967).

5.25 Depending on one's perspective, the purposes of the Stat Plan could be described either as various or obscure. This subject was considered in Decision I-88-1A at paragraph 7.6:

Mr. Monte and Mr. Chan opined that the Stat Plan was developed primarily for historical tracking, not rate making (Transcript, at 652-53, 659, 693). The Deputy Superintendent, Mr. Wells, indicated that the Stat Plan is not designed to meet any particular purpose of the Superintendent but has been used from time to time for particular purposes, including the setting of rates for the Facility Association and for checking 'industry norms and the general environmental indicators' (Transcript, at 838-40).

Representatives of the IBC who gave evidence at this hearing shared the view that companies, usually companies with smaller Ontario market shares, do use published Stat Plan data in some way in rate making, particularly in calculating the average adjusted pure premium or more generally in comparing company experience to industry experience (Transcript, at 947-55). IAO relies exclusively on Stat Plan data to make advisory automobile rates, which are provided to its own membership (Transcript, at 990).

5.26 Mr. Chan, Manager of Actuarial and Statistical Services at IBC, confirmed that all Stat Plan data provided to

the Board (paragraph 5.19) was subject to a series of controls and checks to be outlined below (Transcript, at 929). Two preliminary observations, however, may be useful.

5.27 The first is that the transactions required to be reported under the Stat Plan are coded by the companies themselves and submitted to IBC on magnetic tape or coding forms. This does not imply uniform coding for company purposes, as the Stat Plan provides:

Insurers may use any method for the recording of statistics, convenient to their internal statistical or accounting procedures and codes other than those set forth in this document, provided only that statistics can be reported by the Insurer within the required time in accordance with the instructions, codes, procedures and record formats required by THE PLAN.

5.28 The second is that, historically, neither the recording of company statistics for Stat Plan purposes, nor any "translation" from statistics maintained by the company to statistics on a Stat Plan basis through codes, is audited. Arguably, only the Superintendent legally has such power under the general examination and inspection provisions of the Insurance Act. Mr. Monte, (Vice President, Insurance Operations, IBC) stated that, to his knowledge, the Superintendent has never conducted

an audit focused on company compliance with the Stat Plan (Transcript, at 1309). IBC has not received delegated power from the Superintendent to audit, and IBC does not audit the data at its source (Transcript, at 1065).

5.29 All transaction data received in monthly submissions from insurance companies is subject to certain standard controls and checks, presented diagrammatically in Exhibit 11.3 and analyzed in oral evidence. These may be summarized as follows:

1. Gathering/collection control

Each monthly submission is accompanied by a "Monthly Control Reporting Form". The dollar value of premiums and paid losses, plus the record counts, are given. This form must be signed on behalf of the Company and includes the statement that: "These totals together with endorsements not filed in detail represent all transactions on direct business of the company".

IBC sends a statement to each company every week giving a summary of the status of each submission.

2. Verification

The data is run through computerized edit programs which check that the record totals are in fact those shown on the Reporting Form and which check validity (by field) and consistency (by related fields) (for a detailed description, see Exhibit 3 to Exhibit 11.3).

These programs do not check accuracy, i.e., that the data conforms with the actual transaction being reported (Transcript, at 1003).

If 2 percent or more of the record counts are found to be in error, the complete submission is returned to the company for correction (Transcript, at 924-25). Otherwise, the submission goes to an "accepted file".

3. Year-end Reconciliation

Following the completion of its statutory Annual Statement as of December 31 (which must be submitted by March 1 of the following year), each company must file a reconciliation statement which allows IBC to compare the total of certain Stat Plan data to financial statement data. The figures compared are on a country-wide, not provincial or line, basis (Transcript, at 975-76). Assuming that the data is reconciled, it is added to the aggregated industry data to produce preliminary Green Book exhibits.

4. Reasonability Checks

Preliminary exhibits are subject to manual reasonability checks done by IBC actuarial staff. The consistency of data from year to year is checked (the tolerance is a change from the prior year in excess of 5 to 10 percent (Transcript, at 1301)), as are anomalies in the classification data. If problems are detected, the data usually is excluded from the final publication, with the aggregate of excluded data disclosed in the Green Book (Transcript, at 927).

5. Review by Superintendent

The evidence suggests that the Green Book exhibits are not necessarily reviewed by the Superintendent before publication (Transcript, at 958, 960).

5.30 The evidence in the first and fourth parts of the Industry-Wide Hearing, considered together, suggests that the IBC has taken steps to improve the timeliness, completeness and accuracy of the data (Exhibits 11.3,

11.4), although constant monitoring and continued improvement at the company level are required. Also, given that the check on completeness is a monthly and then year-end reconciliation to the books of each company (implied in the first instance and done in the second), any company may either unwittingly or wittingly maintain books which do not accurately reflect company transactions (Transcript, at 1225). The Stat Plan does not provide any type of sanction for failure to reconcile (Transcript, at 1079). If the books of the company are inaccurate, then that is a significant matter for the appropriate regulatory authority. The computerized verification or edit procedures were neither extensively studied nor evaluated in this hearing. Ms. Bass specifically expressed concern about the rigour of the edits, particularly with respect to coding of critical parts of the data, such as claim counts which influence both frequency and severity calculations (Transcript, at 888).

5.31 The key concern before this hearing, with respect to data quality, is the accuracy of the data for the purposes for which it was used.

D. DATA USED IN CALCULATING ADJUSTED PURE PREMIUM FOR ONTARIO

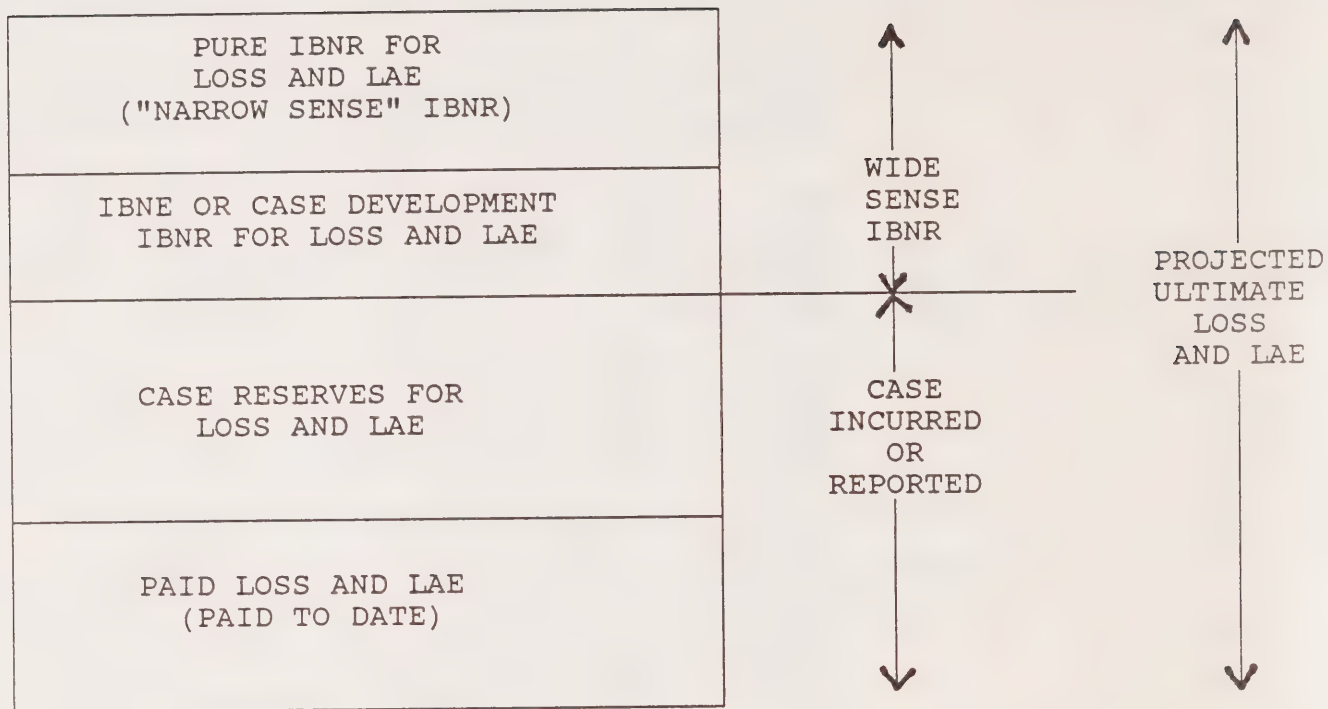
1. Types of Reserves for Losses

5.32 Neither the Board nor Mercer submitted the data received from IBC (or from any other source) to independent verification or audit (Exhibit 5.1, at 4; Transcript, at 109, 306). The Board is considering, as part of the implementation of the Board Statistical Plan, how best to ensure that the accuracy of the data meets appropriate standards and to undertake statistical audits in the future.

5.33 It is difficult to embark upon a review of the evidence on the data underlying the pure premium calculation without summarizing how companies account, or more accurately are required to account, for liabilities arising from claims. For purposes of rate making, losses are grouped by accident year, that is, all accidents which occurred in 1987, whenever reported and whenever finally paid, will be considered together and their development to a fully paid basis tracked together. It should be noted that the data used to calculate pure premiums is industry-wide data for the Province and hence may be referred to as "aggregate data". Reserves are established as follows:

- . once a claim is made, a company must establish a reserve in respect of it, which reserve constitutes a liability of the company;
- . the reserve includes provision for the loss itself and any loss adjustment expense (LAE) directly attributable to that loss;
- . this reserve is known as a "case reserve" and the amount at any time should represent an estimate of the ultimate value of the loss;
- . from time to time, amounts are paid in respect of this claim, until the loss is finally paid or closed without payment and the case reserve is reduced to zero (payments may be made over a number of fiscal or financial years);
- . case reserves can be adjusted one by one as needed, or they can be adjusted "across the board" by a bulk reserve known as "Incurred But Not Enough" (IBNE);
- . at any given time, there are claims which have not been reported to a company and therefore each company maintains another type of bulk reserve known as "Incurred But Not Reported" (IBNR).

5.34 These different types of reserves were shown in a "snapshot" of one year, which is not drawn to scale (a reasonably long-tailed line, such as bodily injury, at an early stage is represented) in Exhibit 11.7 as follows:



Although these amounts can be viewed or grouped by accident years, each accident year's contribution to a calendar year can be ascertained at any given point in time and, in fact, it is that value which is reported on a financial or fiscal year basis.

2. Board Methodology - Unadjusted Pure Premium and Development

5.35 The calculation of the unadjusted pure premium and the adjustment for development are the first two distinct and sequential steps in rate making. In order to best

understand the issues with respect to data, these related steps must be understood.

5.36 The Board methodology requires that -- for calculation of the unadjusted pure premium -- data, by coverage and segmented by limit of liability, from the most recent accident year (1987), valued at 15 months (March 15, 1988) be used. The unadjusted pure premium can be viewed as the product of frequency of claims and severity of claims. Mathematically, the pure premium is equal to total reported incurred claims (paid losses and case reserves) in respect of accidents which occurred in 1987, divided by the number of cars insured in Ontario in that year.

5.37 For any given accident year, however, the paid losses and case reserves may not represent the total amount that insurers eventually will pay to settle finally all claims occurring in that accident year, but ultimately paid in later years. A method of projecting unreported, unpaid and unreserved losses to their ultimate values is through the use of claim development factors derived from several years of historical pure premium development. The choice of development factors made by Mercer will not be discussed in this Chapter, although reference will be

made to certain aspects of historical development of pure premium. It is important to note, however, that if the unadjusted pure premium is not accurate for any reason, this inaccuracy will be magnified in the development process.

5.38 The Board methodology for calculation of pure premium could not be followed because of two limitations on data availability. Data valued at 15 months is not available because loss reporting under the Stat Plan is done on a semi-annual, not quarterly basis. Although data valued at 18 months (June 30, 1988) became available during the final stages of preparation of the proposal, this data could not be used in the calculation of the pure premium but was used in the analysis of trend (Exhibit 5.1, at 11). Also, data for third party liability coverage is not segmented by limit of liability (Exhibit 5.1 at 10; Transcript, at 115-16).

3. Treatment of OHIP Expense

5.39 Background on the amounts paid by insurers to the Ontario Hospital Insurance Plan (OHIP) was given in Decision I-88-1B as follows (paragraph 5.73):

According to the standard agreement between OHIP and individual insurers, an amount is paid to OHIP by insurers based on 'the gross automobile third party liability premiums payable to the Insurer.' The intent of the charge is to cover the costs that OHIP incurs when 'an insured person suffers personal injuries for which he receives services under [The Health Insurance Act, 1972 (now R.S.O. 1980, c.197)].'

In that Decision, the Board decided that the OHIP expense should be included as part of the third party liability pure premium (paragraphs 5.76 and 5.77). In other words, a percentage factor would be applied as one of the adjustments to the unadjusted pure premium. The factor proposed by Mercer is 2.5 percent of third party liability premiums (Exhibit 5.1, at 87) and Mercer included this adjustment in the third party liability rate it proposed.

5.40 Immediately prior to the commencement of the hearing, the IBC notified the General Manager of the Board that "double counting" of the OHIP expense might have occurred in that the accident year paid losses for bodily injury provided by IBC already included OHIP expense, which thus would have been included in the calculated unadjusted pure premiums which Mercer adjusted for, inter alia, the OHIP expense. Ms. Bass was of the view that a correction to the proposal was required, and that the probable effect on the third

party liability pure premium would be approximately a decrease of 2.5 percent. The effect on the overall rate change of removal of the OHIP loading from the paid losses would be about 1 percent (Transcript, at 67-68).

5.41 Subsequent to the completion of the first day of hearings, Mr. Miller, a consulting actuary to the IBC, suggested to a representative of Mercer that, because of the way the OHIP expense was included in the paid losses, more than "double-counting" might have occurred, with the possible result that the downward impact on the overall rate change might be greater (Transcript, at 278-80). Ms. Bass declined to estimate it prior to completing thorough calculations.

5.42 Mr. Miller offered an explanation of the nature of the problem. There is a percentage factor determined each year under an agreement with OHIP. Earned premiums in each calendar year for the bodily injury portion of third party liability are multiplied by this factor to produce a dollar amount. This dollar amount is then added to the bodily injury paid losses for that accident year. For instance, consider accident year 1986. The bodily injury paid losses, valued at 12 months or December 31, 1986, would be increased by the

OHIP dollar amount for 1986. These paid losses, loaded for OHIP, would then be used in the calculation of the pure premium and subject to adjustment for development, trend, etc.

5.43 The result is that the OHIP loading may be "magnified" beyond the simple percentage amount because: (a) premiums may not have a stable relationship with paid losses, and (b) the adjustment factors such as development and trend may justifiably be lower once the OHIP loading is removed (Transcript, at 316-22). Mr. Miller assisted by agreeing to take the necessary steps to modify the computing programs used by IBC to produce bodily injury paid losses without OHIP loading (Transcript, at 342-45).

5.44 Ms. Bass prepared amended exhibits (1, 3, 5 and 7) to Exhibit 5.1 (Exhibit 5.1(b)) and gave evidence at some length on the observable effects of removing the OHIP loading (Transcript, 555-76). Based on a lengthy analysis which included both mechanical recalculation and the retesting of the methodology used (Transcript, at 571-72), Ms. Bass concluded that her original rough estimate of the effect of removing the OHIP loading was accurate because, although the nature of the problem

had changed with elucidation, there were offsetting arithmetic results in the final recalculation. Ms. Bass stated, with respect to the revised (excluding OHIP loading) unadjusted pure premiums and fully adjusted pure premiums (Exhibit 5.1(b)) that (Transcript, at 575):

... as far as I have tested them, I think that they're valid and would hold for purposes of continuing with this Hearing.

5.45 Mr. Miller was cross-examined later in the hearing as to whether he was aware of any other problems arising from the use of the aggregate industry data. He responded (Transcript, at 1266):

We reviewed Ms. Bass' report last week, and that [the OHIP loading] was the one thing we found where she clearly had not understood what the data represented. We didn't find-- I can't say categorically there aren't any other cases, but we, a bunch of actuaries sat down, and sitting down looking at the report could not find any other cases where the data had been clearly misinterpreted as to what it meant.

Q. But certainly you can't tell us that there aren't any more? You found one -- you looked for others, but you didn't find any others?

A. We did not find any others. That is correct.

The evidence does not include any other reference to any other problem related to interpretation of the data.

5.46 Considerable evidence was heard in an effort to ascertain whether the Board was informed by the IBC of the loading for OHIP in the bodily injury paid losses at the time the data was provided to the Board. It may be that the various submissions of data given to the Board included a copy of the "Forward to Automobile Accident Half Year Statistical Exhibit" (Exhibit 11.2) which accompanies that semi-annual exhibit and which explains the OHIP loading at page 3. The Board methodology with respect to the treatment of the OHIP expense had been made clear in the previous Decision of this Board. Although Mr. Miller was not responsible for packaging the submissions that came to the Board (Transcript, at 310-11), he stated that it was clear to him that the aggregate data required should not include the loading for OHIP (Transcript, at 344).

5.47 The Board is concerned about problems of this type, and both the Board and the providers of data must have mechanisms in place to ensure that the data is appropriate given the Board methodology. To some degree, this problem will diminish as more data is

generated by the Board based on the Board Statistical Plan. It will remain, however, a problem in the short term.

5.48 The reaction in some quarters to the problem of the OHIP loading was that it was "an error". In the Board's view, it was not an error. Important information about the data was not highlighted, if it was communicated at all, in the voluminous submissions of data. This type of problem underscores the need, as stated by Mercer, to gain experience with the data (Exhibit 5.1, at 3-4). Furthermore, it illustrates the importance of a thorough and public hearing.

4. Unadjusted Pure Premium for Accident Year 1987 and Implications for Development

5.49 All data used in calculating the adjusted pure premium for private passenger automobile -- from which the overall rate change is estimated -- came from the IBC as statistical agent for the Stat Plan. The data is based on industry-wide experience, that is, on the experience of all insurers writing such business in Ontario, whether in the voluntary market or through the Facility Association. The data was provided separately by coverages: bodily injury, property damage (which

together constitute third party liability), accident benefits, \$100 deductible collision; \$200 deductible and over collision; \$25 deductible comprehensive, \$50 deductible comprehensive, and family protection endorsement.

5.50 Ms. Bass stated that the aggregate data is "roughly in a form that would make it suitable for rate making" (Transcript, at 888; Exhibit 5.1, at 4). This is not synonymous with a conclusion that the data is accurate. It is more likely a reference to the fact that the detail of the data was sufficient to be used in rate making (Transcript, at 718).

5.51 Mr. Monte stated as follows (Transcript, at 806):

... The current Statistical Plan, and exhibits derived from it, can be said to accurately reflect the pure premium requirements based on the experience of Ontario Automobile insurers... I believe that my colleagues with me today, in describing this statistical gathering process, verification and edit processes will affirm the reliability of the aggregate data, that is total exposures, total claims, on which the overall rates are established.

Mr. Chan (Transcript, at 928) and Mr. Yit (Transcript, at 1243) agreed with this conclusion. Mr. Miller cited

personal examples of the use of the aggregate data in rate making (Transcript, at 951-54).

5.52 In pre-filed testimony, Mr. Hunter referred, with respect to the calculation of pure premiums by coverage, to "the data problem" (Exhibit 22.1, at 10) and elaborated as follows (Exhibit 22.1, at 11-12):

Regarding data, Mercer is careful to tell us, over and over again, all the data problems: unavailability of critical data, volatility of data, reversals, errors, coding problems are mentioned on almost every page of the text.

The data problems are most acute, in terms of overall rate level in the use of 12 month data, very immature data, with giant loss developments for Bodily Injury and Accident Compensation. Mercer was forthright in expressing alarm about the jump in pure premiums in 1987 and pyramiding costs if a speed-up occurred.

In testimony, Mr. Hunter observed that "the quality of the data itself underlying all of the work is very tenuous" (Transcript, at 2882).

5.53 In argument, representatives of the New Democratic Party noted that "[T]he control of the statistical base has remained very much with the industry ..." (at 2). This observation is correct, but it ignores the fact that, since 1930, the IBC has acted as statistical

agent for the Superintendent of Insurance and that control falls within that office. Under the Board Statistical Plan, control over data, which can only be obtained from insurance companies, will be exerted by the Board. Realistically, however, data generated under the Board Statistical Plan will not be fully available and useable for some years. The Board is currently considering how best to structure its statistical operations, particularly given the need to balance efficiency with sensibilities about the industry. The Board notes the evidence of Mr. Hunter, the expert witness for the CAC, that in the United States, the statistical agent for a jurisdiction typically is owned and operated by insurance companies (Transcript, at 3614).

- 5.54 The Board cannot draw any definitive conclusion from the evidence with respect to the accuracy of the aggregate data. Although the requirements of the Stat Plan are clear, compliance at the source of the data is not checked and the sanctions for non-compliance, at best, are unclear. Although the Board does not question the appropriateness of the current control, verification and edit procedures for the purposes for which Stat Plan data has been used, the Board is satisfied that more rigorous procedures are needed for

the data that is to be used in industry-wide rate making under the Act. As a practical matter, there may be some existing incentives for insurers to report data accurately, in that Stat Plan data is sometimes used for rate making, and more generally, is used to illustrate the position of the industry, but this is speculation. The Board notes, however, that the criticisms concerning the quality of the aggregate data were very general in nature. For instance, no party attempted to explore how limitations on the control, verification and edit procedures used by the IBC as statistical agent might fail to ensure data of sufficient quality. Nonetheless, the Board agrees with Mercer that the most that can be said about the aggregate data is that it is roughly suitable, but not demonstrably accurate. The Board does not agree with the written argument of Ms. Schaeff that "[T]he data which forms the basis of the Mercer Report has been found to be insufficient, unreliable and incomplete." Ms. Schaeff's concerns and sense of caution, however, are shared by the Board. The Board is of the view that the data, and indications derived from the data, must be used and applied very cautiously both because of the concerns about its accuracy and experience with the data base.

- 5.55 It should be noted that most of the issues with respect to aggregate data, apart from overall concerns about accuracy, arise with respect to the data for bodily injury losses. The bodily injury portion of third party liability coverage accounts for about 46% of the total average premium and therefore these issues are significant.
- 5.56 The unadjusted pure premium for bodily injury for 1987 is \$144.12 (Exhibit 2 to Exhibit 5.1(b)). This represents a 25.7 percent increase over the comparable figure for 1986. There was general agreement with the conclusion drawn by Mercer that this change from the prior year, looking at incurred losses valued at 12 months only, was "significantly higher" than the change from the prior years, 1986 and 1985 (Exhibit 5.1, at 12). As Mr. Hunter stated, "immature years have a tendency to have some radical possibilities" because of the effect of development (Transcript, at 2973).
- 5.57 The unadjusted pure premium is intended to be a measure of true underlying loss costs, which costs are developed to an ultimate paid amount. Although the treatment of the indicated unadjusted pure premium for 1987 will be reviewed in Chapter 6, it must be considered whether the evidence establishes that the

data with respect to incurred losses is either inaccurate or misleading (that is, representing factors other than increases in the underlying loss costs).

5.58 Put differently, the question is whether the amount of incurred losses (paid losses plus case reserves) has been affected by a factor or factors other than increases in loss costs. Pure premiums are dynamic in that they are based on two factors: frequency (number of claims divided by number of cars) and severity (dollar value of incurred losses divided by number of claims).

5.59 Mercer provided information on the frequency of claims (Exhibit 5 to Exhibit 5.1(b)) which indicated that the change in claim frequency for bodily injury from 1986 to 1987 was 14.3%, a greater increase than in 1985 and 1986. Looking at all years from 1978 to 1987, frequency was described as erratic or volatile (Exhibit 5.1, at 10, 17; Transcript, at 110, 149-50), a conclusion which was not challenged in evidence. Furthermore, most coverages were volatile (Transcript, at 717). Mr. Miller was of the view that the claim frequency for 1987 is "real" (Transcript, at 1231, 1325) and that volatility per se does not suggest a problem with data quality.

- 5.60 Mercer could not determine the root causes of frequency volatility (Exhibit 5.1, at 15; Transcript, at 110, 718), nor did any other participant in the hearing brave an explanation.
- 5.61 The components of severity are incurred losses and number of claims, the latter also being a component of frequency. In 1987, incurred losses increased by 29.4 percent over 1986 (Exhibit 3 to Exhibit 5.1(b)), and incurred claim counts increased by 17.3 percent (Exhibit 4 to Exhibit 5.1). The change in severity was 10.4 percent (Exhibit 5 to Exhibit 5.1(b)). It should be noted that the volatility of claim severity was not of the magnitude of volatility in claim frequency (Transcript, at 150).
- 5.62 No evidence was presented as to whether the number of claims in 1987 is accurate or anomalous. The evidence centred on whether the incurred losses were increased as a result of a speed-up in claims processing (which would increase the paid claims) or a strengthening of reserves (which would increase the case reserves).
- 5.63 The possibility of reserve strengthening took on a somewhat pejorative quality at the hearing. Reserve

strengthening that is driven by increases in the amount of claims is both required by law and a business necessity. This type of reserve strengthening is based on increases in losses and should be captured in the unadjusted pure premium. Both the federal and Ontario insurance regulatory statutes require that the reserves maintained by each licensed company at year end 1987 (and subsequent years) be certified by a qualified person as part of its statutory annual statement (Decision I-88-1C, paragraph 3.12). It obviously is not apparent from the evidence whether, and to what extent, certification may have resulted, and may continue to result, in increased case reserves given the underlying losses. In any event, the concern about reserve strengthening does not refer to the process of establishing adequate reserves, but rather to the fact that reserves may be increased for purposes other than maintaining reserve adequacy.

5.64 On the subject of claims processing and reserve strengthening, Mercer concluded, based on the information available in the preparation of the rate proposal (Exhibit 5.1, at 13):

It is not our understanding that case reserves have been strengthened nor are we aware that any outside influence has caused the 1987 accident year pure premium to be

artificially high on a 12 month basis. To validate our observations, we examined these same pure premiums developed as of 18 months as provided in update experience from the IBC and find that the patterns are holding for 1987. In addition, we examined pure premiums on a paid basis to eliminate the potential effects of case reserve strengthening, and conclude that they too exhibit a significant increase from 1986 to 1987.

5.65 Ms. Bass compared the ratio of incurred losses to paid losses following removal of the loading for OHIP from the incurred losses (paragraph 5.44 above). She observed a declining ratio of paid to incurreds and commented on the possible causes as follows (Transcript, at 574-75):

It could have been a strengthening in the case reserves because whenever you see a change in the ratio, either the numerator can change or the denominator can change, or both could be changing a little. So we could have had a strengthening in the case reserves, which would mean the denominator was changing. It could have meant that there was a slowdown in payments because the numerator was changing and getting smaller. Or it could have been some combination of the two of them.

Q. And of the three candidates, what did you conclude?

A. We concluded that there was a slowdown in the payment of claims. There is a trend toward increasing development in paid development factors in the later years. It is coupled with an overall decline in the ratio of paid-to-incurred ratios at virtually all points of development.

Those two things together indicated to me that development is now taking place later, it is being pushed to later years, and that would mean that there is a shift in the underlying paid patterns that we must be very careful of.

Ms. Bass concluded that this analysis supported development based on incurred claims, not paid claims. On the more limited point of the reasons for the increase in severity in 1987, this evidence is inconclusive because the slowdown could be occurring after the first twelve months and it might occur inconsistently across accident years.

5.66 The major proponent of the view that the increase in severity in 1987 is not attributable to an increase in underlying loss costs was Mr. Hunter. He did not support his conclusion by arguing that a speed-up in claim payments has occurred. Rather, he was strongly of the view that case reserves had been strengthened.

5.67 Mr. Hunter put the reserve strengthening issues in perspective against the backdrop of the overall average rate increase (Transcript, at 2990-91):

... I believe that, to be on the safe side, you need to make some adjustment to a straight out 87-- some adjustment to your original decision of just using the latest year with full incurreds and full trends. I

think there has to be some consideration given to the possibility of reserve strengthening, making the underlying pure premium more adequate, and then also building up the loss development factor. When you multiply the two together you get a pyramiding effect and then you hit it with a trend, I think there is concern; legitimate concern. And I believe Mercer has adjusted to a two year basis in part to reflect that. I go further, but I believe there is plenty of testimony that there needs to be some kind of adjustment.

Although Mercer did not agree with Mr. Hunter's conclusion or advocate his solution, in its proposal Mercer made clear that if the 1987 pure premiums represented something other than a true increase in loss costs, the ultimate development may be significantly less (Exhibit 5.1, at 13).

5.68 Mr. Hunter argued that the following circumstances would operate as very real practical incentives to strengthen reserves in 1987:

- . Property and casualty insurance companies operating in the United States are at the peak of the current profitability cycle and it is common practice for insurers to build up their reserves at such a time (Transcript, at 2973, 2990, 3438, 3590). He stated that it is company-wide profit that matters, and not the profit or loss situation by line (Transcript, at 2990, 3590).
- . Companies would respond to the establishment of the Board by

strengthening reserves (Transcript, at 2973, 2990). Mr. Hunter did not elaborate on this reason. Possible implications are that the strengthening of reserves would be done to cause profit to be understated, or it might be done in anticipation of reduced opportunity to increase rates.

- . For tax years commencing with 1989, insurers will be required to discount reserves for tax purposes (Transcript, at 3436). The implementation of similar tax treatment in the United States was preceded by a period of reserve strengthening (Transcript, at 3593).

(An explanation of the profitability cycle and the tax discounting of reserves can be found in Decision I-88-1C, at 175-81 and 152-67, respectively).

5.69 Board Counsel questioned Mr. Hunter with respect to the evidence of a number of company officials that the reserves in respect of automobile losses maintained by each of their companies were adequate. It was Mr. Hunter's view that such statements lent credence to his view that reserves had been strengthened. Board Counsel indicated that the company officials also had stated that reserves had been adequate over the previous few years. Mr. Hunter conceded that the experience with respect to reserve strengthening might be different in Canada than in the United States (Transcript, at 2989).

5.70 Mr. Howard cross-examined Mr. Hunter on his knowledge of insurer profitability in Canada and the timing of the establishment of the Board. Mr. Hunter was of the view that company-wide profitability has risen within the last two to three years in Canada. Mr. Hunter was not aware of when it became apparent that the creation of the Board might be a response to developments with respect to automobile insurance (Transcript, at 3439). Mr. Hunter did not agree that the strengthening of reserves necessarily must be done on a case-by-case basis. Case reserves generally are reviewed at least annually, and case reserves can be increased through IBNE reserves (Transcript, at 3440-41).

5.71 Mr. Miller stated that his analysis, particularly of the loss development triangles, did not indicate "clear reserve strengthening" or "a consistent reserves strengthening in the last year or so" at the aggregate level. He also stated that he could not say that reserve strengthening had not taken place (Transcript, at 1312).

5.72 The debate around claims severity -- whether claims were paid more quickly or case reserves strengthened in 1987 -- underlies the very real, and very big, challenge that is presented by industry-wide rate

making. Ms. Bass and Mr. Hunter -- two expert actuarial witnesses with impressive qualifications in the industry, but admittedly little direct experience in the Canadian portion of a largely foreign-owned industry -- disagreed on the interpretation of the 1987 claims severity, and in particular, on whether case reserve strengthening had occurred in 1987. Mr. Miller, a very experienced Canadian actuary, favoured the view that reserve strengthening had not occurred, but he was not prepared to argue that the data ruled out the occurrence of case reserve strengthening. In the Board's view, the evidence neither proves nor disproves the existence of case reserve strengthening. As a result, it is the Board's opinion that no suitable explanation has been given for either the claim frequency or claim severity observed in 1987. In these circumstances, Mercer deviated from the Board methodology and recommended that the 1987 pure premium be weighted at 70 percent (instead of 100 percent), and the 1986 pure premium at 30 percent. The Board's view of this proposal will be given in Chapter 6.

5. Development and IBNR

5.73 Mercer found the development patterns to be stable and, in respect of each accident year, therefore selected

the weighted average of the development factors for the most recent three years (Exhibit 5.1, at 12; Exhibit 2 to Exhibit 5.1(b)) to be used in calculating the 1989 rates. For the reasons explained at some length in the preceding section, however, Mercer expressed concern about the unadjusted pure premiums to which the development factors would be applied, but (Exhibit 5.1, at 12) followed the neutral path of using the historical development factors.

5.74 Mercer selected a development factor for each accident year, by coverage. The ultimate value of all outstanding claims in each accident year was calculated by multiplying the incurred losses by the development factor. All of the ultimate losses for all accident years by coverage were aggregated. The ultimate losses, aggregated by coverage, represent the total ultimate paid losses for all years. The difference between the total ultimate losses and the total incurred losses for all years is the "wide sense IBNR" for all coverages. The "Mercer imputed" IBNR is \$1.245 billion (Transcript, at 3335).

5.75 Drawing upon the issues and evidence in the third part of the Industry-Wide Hearing -- on profitability -- the amount of the wide sense IBNR became an issue in this

hearing. In that part, the Board considered two other IBNR numbers for the OAI (Decision I-88-1C, paragraph 9.30). The first was derived by aggregating the IBNR amount reported by each company to the Board as of December 31, 1987 in the Financial Reporting Package (FRP) circulated by the Board. The second came from IBC and it, like the Mercer figure, is an imputed number (Transcript, at 1305). The IBC takes the incurred losses reported to it for any given year and develops those losses to an ultimate paid basis. Nothing is simple, however, and these numbers (industry-wide, for 1987 and prior accident years) differed significantly, as of December 31, 1987, as follows:

IBC:	\$1,517 billion (Exhibit 11.6)
Mercer:	\$1,245 billion (Transcript, at 3335)
FRP:	\$801 million (Exhibit 11.6)

5.76 The IBNR issue has a certain impenetrability that may have caused its implications to be misunderstood. In particular, the calculation of the unadjusted pure premium does not depend on insurer-reported IBNR amounts because the pure premium development process is based only on incurred losses, IBNR being calculated

implicitly. Thus, Mercer did not use data from the industry (either IBC or FRP) in the development process, but as described in paragraph 5.72, imputed its own IBNR from the accident year incurred losses shown in the Stat Plan data. Mercer correctly confirmed on several occasions that the failure of the IBC and FRP IBNR amounts to reconcile did not affect the Mercer rate proposal (Transcript, at 108, 125, 254-55, 769-72, 3335). More pointedly, the reconciliation problem has not been imported into the proposed rates through the use of problematic IBNR data.

5.77 These IBNR amounts became the subject of lengthy scrutiny in this hearing because, if it could be shown that the incurred losses might develop to an ultimate paid cost that was less than that projected by Mercer, then the development factors and the adjusted pure premium might be reduced accordingly, perhaps significantly.

5.78 The Board, in the decision on profitability, had speculated on the reasons for the difference between the IBC and FRP amounts and suggested the following possibilities: coding errors in statistical plan data submitted to IBC; differences in definition of IBNR; differences in methodology of calculation; and under

reserving by the industry and/or over reserving by the IBC.

5.79 In this Hearing, Mr. Miller gave evidence with respect to a detailed study he had completed attempting to reconcile the difference between the IBC and FRP numbers (Exhibit 11.6). He was able to reduce the difference from \$716 million to \$600 million through an analysis of the treatment of unallocated loss adjustment expense and an adjustment for missing data. For the remainder, he queried whether (Exhibit 11.6; Transcript, at 2628-50):

- . companies reported narrow sense IBNR on the FRP instead of wide sense IBNR as required (companies report the former for statutory accounting purposes);
- . companies reported wide sense IBNR on a net (of reinsurance) basis (as required in statutory accounting) as opposed to on a direct basis (as required by the FRP);
- . companies used an unreasonable basis to allocate wide sense IBNR by province and by line (companies have not been required to do so before the advent of the Board); and,
- . companies maintained inadequate wide sense IBNR.

Board Counsel noted in argument that the first three possible explanations could not be validated, nor could

the amount of difference associated with each assumption be accurately quantified. Representatives of one company did state in evidence that its wide sense IBNR had been misallocated and was understated by \$600,000 (Dominion, Transcript, at 1926).

5.80 Much of the evidence focused on the adequacy of reserves maintained by companies, the implication being that if reserves are adequate industry-wide, then development factors could be related to such reserves. A specific methodology designed on this assumption will be discussed in Chapter 6.

5.81 Pre-filed evidence and testimony were given by senior executive officers of seven companies which accounted for 38 percent of the direct written premiums of the OAI in 1987 (Submission of Board Counsel, at 7/1). The officers of each company stated that their company's loss reserves, including IBNR, were adequate in 1987 and continue to be adequate (Submission of Board Counsel, paragraph 4.6). They also suggested that the IBC/FRP difference in IBNR was attributable to reserve inadequacy in the OAI (Submission of Board Counsel, paragraph 4.8).

5.82 It must be remembered that monitoring of reserve adequacy is an important statutory responsibility of the Ontario and federal Superintendents of Insurance (Decision I-88-1C, Chapter 3). For purposes of this hearing, the Board's interest in reserve adequacy is limited to the potentially broad subject of the relationship between loss development and rates.

5.83 The very real problem, for the companies and the OAIB alike, is that reserves are an attempt to value in the present something that will not fully be known until the future, that is, the ultimate value of a claim. Reserves can be consciously manipulated, poorly estimated, subject to the vagaries of randomness or any combination of these. Ms. Bass considered it unlikely that the reserves of all companies are adequate (Transcript, at 3309). Mr. Miller "firmly believes" that case reserves are inadequate to cover loss development, which is supported by the impressive size of the IBNR amounts in evidence before the Board (Transcript, at 1315). There is historical evidence that the IBNR itself is inadequate in some years (Exhibit 11.6, at 5; Transcript, 1322, 1328).

5.84 The relationship between reserving and pricing was touched upon in evidence (Transcript, at 3346-49;

Submission of Board Counsel, Section 7.6; Final Argument of Safeco, at 3-4). While both are based largely on estimated claim or loss development, reserves are established for statutory or financial accounting purposes that can be described as "retrospective", while pricing is "prospective". Quite apart from the fact that there is no standard methodology for establishing reserves (Transcript, at 2663-67), different factors affect the final selection of reserve levels (Transcript, at 3349) and prices (Submission of Board Counsel, paragraph 7.15). The relationship between the two is a very important part of the Board's continuing analysis of business practices and profitability.

- 5.85 In the Board's view, the different IBNR figures do not assist it in any way in understanding the reasons for the claim frequency and severity that the data indicates for 1987, nor in establishing how development factors might be calculated. The Board agrees with the submission on behalf of Safeco (at 4) that the accuracy of the FRP IBNR cannot be established. Doubt has been cast upon the degree to which companies (for whatever reasons) complied with the instructions for completing the IBNR; statutory reserves, including and perhaps particularly IBNR, can be manipulated, mishandled or

inadequate; and pricing, in any event, draws on a range of considerations that include but are not restricted to loss development. Further, it was not considered in evidence whether the development factors used by IBC to reach its imputed IBNR are preferable to those of Mercer.

6. Other Adjustments

5.86 "Development" reflects the ultimate costs of all prior accident years and "trend" reflects projected cost levels expected to prevail during the year for which rates will be in effect, that is, 1989. In many ways, trend is analogous to a prospective price index for claims. It was decided in Hearing I-88-1B that claims costs trending procedures should be based, taking the most recent five years, on a combination of (1) the trend of historical pure premium; (2) the trend of historical claim frequency and historical severity, determined separately and then combined; and (3) the trend of some external index related to the cost of automobile insurance. The appropriate weighting of the trend factors was to be determined in this hearing.

5.87 The principal problem that arose in calculating trend was how to regard, and how to treat, the volatility in

frequency (paragraph 5.59) which is unusual for such a long period in a database this large. This volatility was observed for every coverage (Exhibit 5.1, at 17). Reliance on the most recent five years would produce an annual trend that was unreasonably high (Exhibit 5.1, at 14). Mercer did not choose to recommend that the frequency trend be excluded for the following reason (Exhibit 5.1, at 15):

... severity is dependent on the claim count and thus it, too, could be affected. If claim counts were artificially high, then severities would be correspondingly low, *ceteris paribus*.

Although it is recognized that the accuracy of the coding of company data in accordance with the Stat Plan is particularly important with items such as claim counts, the Board heard very limited evidence about the accuracy of claim counts. Mercer recommended that the frequency trend be measured over the most recent ten year period, which, inter alia, necessitated amendments to the Board methodology (Exhibit 5.1, at 16-18).

5.88 The bulk of the data used for the remaining adjustments -- catastrophe (in the case of comprehensive), unallocated loss expense, differentials in the third party liability premium by limit of liability -- could

not be obtained on an industry-wide basis. Details of the data used will be given in Chapter 6. The issue of an adjustment for rate group drift for collision and comprehensive coverages will be considered in Chapter 10. All of this data suffered from one or more possible limitations on data quality: it was submitted on a voluntary basis (unallocated loss expense); it was drawn from a survey of large insurers (differentials); it was anomalous (pure premiums for collision and comprehensive at \$100 and \$200 deductibles); it was incomplete in development (family protection endorsement). In each case, Mercer disclosed the source of the data, commented on the limitations and recommended how the data or the resulting indication should be treated.

E. DATA USED IN DETERMINING DIFFERENTIALS BY CLASS

5.89 The calculation of the average adjusted pure premium for Ontario utilized aggregate data. The purpose of classification rate making is to distribute the average province-wide pure premium for each coverage among the classes of risk exposure (paragraph 5.6). In the Board methodology, the relative claim experience of insureds in each class is to be compared to the province-wide experience. Mercer, therefore, in order to select

classification differentials, needed claims and exposure data for each class of risk exposure included in the Board Class Plan for private passenger automobiles.

5.90 It has already been noted that the only industry-wide data available in Ontario is based on the Stat Plan. The Stat Plan data has two important limitations for classification rate making (apart from the general concerns about completeness, validity and accuracy).

5.91 First, the Board Class Plan includes classes for the category of private passenger automobiles that are not included in the Stat Plan, for example, annual driving distance and conviction history. Second, each licensed company has had the freedom to adopt its own classification plan and the experience with respect to these classifications has been reorganized or "translated" into the classes included in the Stat Plan. The definitions used in a company class plan may differ in minor or significant respects from the definition of the related classes in the Stat Plan. Further, the translation is accomplished through coding that may be inconsistently completed.

- 5.92 The IBC was careful to indicate to the Board that, in its view, the Stat Plan data respecting classification variables is "less reliable" than the aggregate data (Transcript, at 806-07). Although the Board understood Mr. Chan to say that the Stat Plan data provided by classification was subject to all of the procedures described in paragraph 5.29, Mercer observed numerous examples of reversals and anomalies.
- 5.93 Mercer utilized data drawn from sources other than the Stat Plan. For the reasons described above, this was necessary in order to obtain information that was not available under the Stat Plan, or to validate or replace problematic data from the Stat Plan. Mercer specifically identified data from the IBC and the IAO that was utilized (Exhibit 5.1, at 38). For collateral sources, Mercer surveyed current Ontario insurer rate manuals and used data from other jurisdictions with classes of risk exposures similar to the Board Class Plan. The specific data used with respect to each class of risk exposure will be identified and reviewed in Chapter 6.
- 5.94 Ms. Bass was cross-examined closely by Mr. Baggaley, representing the CAC, on the use of data from collateral sources, particularly the current market

practices of insurers as stated in their rate manuals. Mr. Baggaley suggested that current industry differentials "may have been developed for competitive reasons, some of them may have been primarily based on actuarial evidence, some of them may have been practices that will no longer be allowed in a regulated environment..." (Transcript, at 725). Ms. Bass stated that, in her view, the downward pressure on prices created by competition in this Province probably means that the differentials have been related to the underlying experience of each company. She also confirmed that Mercer did not place any weight on practices that will be prohibited under the Board Class Plan (Transcript, at 724-25).

5.95 Ms. Bass described the conundrum presented by the use of data that is ill-fitted to the Board Class Plan. The Board could reject the data, in which case each Ontario insured would be charged the same final rate based on the average adjusted pure premium plus expenses. It should be noted that this would not avoid the problem of premium dislocation (Transcript, at 709-10). The premiums paid by individuals currently do reflect differences in their risk profiles and, if the Board did not undertake classification rate making

because of data problems, the risk profile of insureds would be irrelevant to the premium charged in 1989.

5.96 If the Board proceeds with classification rate making, it is clear that neither the Board nor the public can be completely assured that each insured is paying the correct rate. Even with data of the highest quality, the system is unlikely ever to be this precise. Recognizing the limitations of the data, Ms. Bass made a general statement as to how Mercer had exercised professional judgment in selecting the differentials (Transcript, at 709-10):

I think that whenever we went through and set [the] classification differential[s], we had a lot of concern for how it would impact the individual consumer, and that's why in each and every instance we chose between the two opposites that we had, we could either do nothing, which would mean that everybody pays exactly the same, or we could follow the extreme of every indication that we got, and we chose not to. We chose to pull those in a little bit...If my neighbour's premium goes up, maybe my premium goes down, if my premium goes up, maybe my neighbour's goes down. Its the same thing. I can't look at every risk. But I can try the best I can with the information I have to moderate that to the best of my ability and still implement the class plan, still rely on the information and do something because the option is really to do not much at all.

The choices made by Mercer with respect to each class of risk will be considered in Chapter 6.

F. CONCLUSION

5.97 Data that is accurate -- and that can be shown to be accurate -- is critical to both the day-to-day functions and the overall credibility of the Board. To a very considerable extent, everyone interested in the subject of automobile insurance is a captive of the data that is available today and into the near future. Until data under the Board Class Plan is available and considered to be reliable, the data used in rate making will be contentious. In the Board's view, the limitations of the aggregate data and the classification data are not sufficient to warrant rate making by some surrogate method. Rather, rate making should incorporate a very critical approach to the data and its indications.

6. THE OVERALL RATE LEVEL

A. THE ACTUARIAL EVIDENCE

1. Introduction

6.1 The rate proposal for private passenger automobile that was the focus of the evidence at the hearing was prepared by an independent firm of consulting actuaries, William M. Mercer Ltd. (Mercer), engaged by the Board pursuant to section 7(2) of the Act. Under the terms and conditions of its retainer, Mercer was required to propose rates for classes of risk exposure prescribed in the Board Class Plan established by the Decision in Hearing I-88-1A. The rate proposal was to utilize the rate making methodology and to incorporate the profitability standards set out in the Decisions of the Board in Hearings I-88-1B and I-88-1C, respectively.

6.2 The rates proposed by Mercer were estimated to be approximately 35 to 40 percent, on average, above current rate levels. It was noted, however, that this figure could vary significantly from coverage to coverage and might be much greater in some cases because of the dislocation caused by the simultaneous

introduction of a new classification plan (Exhibit 5.1, at 1-2).

6.3 Mercer pointed out that the proposed rates comprised two elements: (1) an adjustment for pre-existing rate inadequacy; and (2) the expected annual change in claim frequency and average size of claims (that is, loss costs) projected to the prospective rating period. The prior existence of rate inadequacy, and some of the reasons therefor, have been discussed in Chapter 3 of this Decision. Mercer noted that, had automobile insurance rates been monitored for adequacy on a regular basis over the years, and had appropriate rate changes been made, the proposed change in premiums would have been approximately equal to the annual loss cost trend, which Mercer estimated to be 9.9 percent.

6.4 It is important to note that the Mercer rate proposal was an actuarial estimation of the rates necessary (1) to enable insurers to cover the cost of claims arising out of policies issued between March 15, 1988 and March 14, 1990; and (2) to provide insurers with an opportunity to earn the ROE of 12.5 percent established by the Board in its Decision in Hearing I-88-1C.

6.5 An actuary is a professional with expertise in applying mathematical probabilities and statistical analysis to data for the purpose of estimating the present financial value of future contingent events. Two points deserve emphasis.

6.6 First, actuarial conclusions about future contingent events are based on mathematical and statistical assumptions. These assumptions may be challenged on theoretical and practical grounds only. It would not have been appropriate for Mercer to modify its estimates of actuarially adequate rates by considerations of social policy, such as affordability to consumers. As stated by Ms. Bass, a witness for Mercer, in cross-examination by Mr. Rae of the New Democratic Party (Transcript, at 816):

The purpose ... of the actuarial study is to apply some principles to the data at hand, come up with the indicated numbers as best we can.

It is, I believe, the Board's - certainly not my responsibility - to then further interpret that as to whether this is just and reasonable in a non-actuarial sense.

6.7 Secondly, actuarial conclusions concerning future results are affected by the quality of the data used. If the data underlying the actuarial analysis is

faulty, the conclusions concerning future events may be incorrect. The data employed by Mercer in estimating the required rate changes was supplied by the IBC as statistical agent for the Superintendent of Insurance. The infirmities of this data are detailed in Chapter 5 of this Decision. Mercer was not itself responsible for the data, but rather for its professional opinion concerning the appropriate actuarial treatment of the data.

6.8 Before turning to the evidence relating to other matters to be considered by the Board under its mandate under section 20(4) of the Act to set rates that are "just and reasonable and not excessive or inadequate", it is proposed to deal with the Mercer Proposal and with the actuarial challenges to the Mercer conclusions concerning the indicated rate level.

2. The Mercer Proposal

(a) Data

6.9 The data underlying the overall rate level proposed by Mercer was supplied by the IBC, which aggregated private passenger auto insurance data for all insurers that write such insurance in Ontario, including the

Facility Association. The data comprised total insurance accident year claims data valued as of December 31 each year, and was provided separately by coverage.

6.10 The data supplied by the IBC to Mercer included the following: paid losses plus allocated loss adjustment expenses; incurred losses plus allocated loss adjustment expenses (that is, the sum of paid amounts plus case reserves); and incurred claim counts. Calendar year exposure data was supplied on both a written and an earned basis.

6.11 Mercer did not conduct an independent audit of the data. Much of the evidence presented at the hearing concerned the quality of the aggregate data and its suitability for purposes of estimating required overall rate levels. While Mercer was of the view that the aggregate data was generally suitable for this purpose, it noted certain features of the data that affected its approach to estimating the requisite overall rate level. In particular, Mercer expressed concern about a substantial increase in 1987 accident year losses for some coverages, as well as volatility in frequency data for a number of coverages.

(b) Methodology

6.12 While the Mercer Proposal adhered generally to the rate making methodology established by the Board in its Decision in Hearing I-88-1B, certain departures from that methodology were necessitated by restrictions in the availability of data. For example, because data is reported to the IBC as of December 31 and June 30, it was not possible to value accident year data as of 15 months, as required by the Board. In other cases, because of perceived anomalies and deficiencies in the data, Mercer departed from the Board-established methodology on the basis of judgment. Departures from the methodology prescribed by the Board are documented by Mercer in Exhibit 5.1, and are summarized in the Submission of Board Counsel at 2/37-2/41.

(c) Average Pure Premium

(1) Unadjusted Pure Premium

6.13 Under the methodology approved by the Board in Hearing I-88-1B, the first step in arriving at the pure premium is to calculate the unadjusted pure premium by dividing the most recent accident year total claim dollars, valued at 15 months, by calendar year total earned

units of exposure. As indicated, because of IBC data reporting deadlines, it was not possible to value the 1987 accident year data as of 15 months. Moreover, "because annual changes in the underlying pure premiums, claim frequencies and severities proved to be too erratic to base the estimate of the projected pure premium on a single accident year", Mercer relied on two accident years, 1986 and 1987, valued as of December 31, 1987, rather than entirely on 1987 accident year claims data. Mercer attached 70 percent weight to the 1987 data and 30 percent weight to 1986, as these are the traditional weights used for private passenger automobile by the IAO (Exhibit 5.1, at 11-12).

6.14 The 70/30 weighting assigned by Mercer was not challenged by the Industry Coalition. Evidence filed by individual insurance companies indicated that other weightings are not without precedent (Exhibit 12.2, at 1, item 5; Exhibit 20.1, at 3, item 2).

6.15 The actuarial expert witness for the CAC, Mr. Hunter, was of the view that, for reasons of data quality, even less weight should be given to the 1987 data, and suggested a weighting of 50 percent for each of 1986 and 1987 (Exhibit 22.1, at 13).

(2) Loss Development

- 6.16 In accordance with the methodology prescribed by the Board, Mercer applied to the unadjusted pure premium a development factor, which is an adjustment to reflect the fact that, at the close of the historical experience period, not all claims and allocated adjustment expenses have been reported, reserved or paid. The development factor is intended to adjust the data to the level at which the claims will ultimately be paid.
- 6.17 Although it did not depart from the methodology prescribed by the Board for estimating development, Mercer cited its inability to use data valued at 15 months and noted that, while the historical development patterns were stable, "it is not without much consideration that we apply the set of development factors to the claims data at hand" (Exhibit 5.1, at 12). Mercer pointed out that the change in pure premiums from 1986 to 1987 (25.5%) was significantly higher than the change from 1985 to 1986 (8.2%) and from 1984 to 1985 (13.0%), stating as follows (Exhibit 5.1, at 12, emphasis added):

We have assumed in our selection of development factors that 1987 will develop along the same patterns as established over the prior years. If, however, the increase in pure premium for 1987 as of 12 months represents a speed-up in claims processing or a strengthening in new case reserves (rather than a true increase in underlying loss costs), ultimate development may be significantly less than the expected 95.6%.

6.18 Mercer's assumption that 1987 would develop in accordance with the historical development patterns was based on two factors. Mercer found no direct evidence of either an increase in the strengthening of case reserves or of a speed-up in the processing of claims. Moreover, Mercer noted that, in 1983 and 1984, when a similar dramatic increase in loss costs had occurred, the historical development patterns had proved to be appropriate (Bass, Transcript, at 122-24).

6.19 Mercer indicated that, if the 1987 loss data did not represent a true increase in loss costs, an appropriate adjustment might be to fit the average change in pure premiums over the prior 9 years to an exponential curve and, having projected the 1987 pure premium on this basis, to apply the historical development to that figure (Exhibit 5.1, at 12-13; Bass, Transcript, at 124).

a. The CAC Position

6.20 At the request of the CAC, Mercer recalculated its projected pure premiums based on paid, as opposed to incurred, losses and allocated loss adjustment expenses (Exhibit 4.1.1). In evidence subsequently filed by the CAC, Mr. Hunter concluded, on the basis of his analysis of the paid claims development data, that the Mercer loss development factors for bodily injury (Exhibit 1 to Exhibit 5.1(b)) and accident benefits (Exhibit 16 to Exhibit 5.1) were excessive.

6.21 While there was some disagreement concerning whether the methodology employed by Mr. Hunter should be characterized as a paid loss development, as suggested by Ms. Bass and the Industry Coalition, or as a "modified incurred" loss development as maintained by Mr. Hunter, the process may be summarized briefly as follows (Submission of Board Counsel, at 6/1-6/2):

6.3 ... The CAC proposal began the process by calculating paid development factors. It then estimated ultimate losses and allocated loss adjustment expenses for 1986 and 1987 based on these factors. These ultimate losses and allocated loss adjustment expenses were then divided by the incurred losses and allocated loss adjustment expenses reported as of December 31, 1987.

6.4 The CAC thus 'imputed' development factors for bodily injury and accident benefits coverages which it then adjusted upwards [to give some weight to the incurred losses] (Exhibit 22.1, unnumbered pages titled Exhibit 1, 16, and JRH Exhibit A and B).

The loss development factors imputed by the CAC pursuant to this methodology were substantially smaller than those estimated by Mercer.

6.22 The evidence of Ms. Bass (Exhibit 4.1.1, at 2-4) outlined several reasons for not using paid loss development for long-tail coverages. The reasons adduced are summarized in the Submission of Board Counsel as follows (at 2/5-2/6):

- (1) Reliance on paid claims amounts for a long-tail coverage essentially means that the entire estimate of the ultimate losses is based on the sum of current paid losses which, at 12 months of development, represent about 4% of the ultimate value;
- (2) There is tremendous volatility in paid development factors from 12 to 24 months;
- (3) The impact of changes in the Ontario litigious climate on claim frequency and the impact of landmark court decisions on automobile liability claim size are generally not observed early in the payment stream;

- (4) By relying on paid claims, a substantial amount of claims knowledge is ignored since case reserves are not considered; and
- (5) In the instant case, paid claim counts are not available and thus trend analysis is hampered significantly.

6.23 Mr. Miller, consulting actuary for the IBC, also emphasized the potential for error in relying on the sum of paid losses at 12 months development, stating (Transcript, at 2626):

... for long-tailed lines, such as Ontario auto BI, actuaries, in general, seem to have some difficulty with using a strictly paid analysis for projection, because [the sum of paid losses] is so small, any small error or small random burp ... will get magnified greatly in the projection. When you do an incurred analysis, there could be small problems there, but they won't get magnified nearly as much when you go up to your projected ultimate.

6.24 The actuaries for seven individual companies that gave evidence before the Board all indicated that they used incurred losses in estimating development, although it was agreed that reference to paid claims is not inappropriate in some circumstances. Mr. Oakden, consulting actuary for Pilot, for example, identified two instances in which he might use paid claims data. First, he stated (Transcript, at 2568):

If I was doing loss reserving and rate-making for the same company and I felt that the incurred losses were distorting the results, I might look at paid losses or I would attempt to use the paid losses to adjust the incurred losses for a change in the reserving practices.

Secondly, during the course of cross-examination by Mr. Baggaley of the CAC, while emphasizing that he would be very reluctant to use paid claims data even on an industry-wide basis, Mr. Oakden stated as follows (Transcript, at 2583):

So unless the reported data is suspect or very poor, one would be very reluctant to use paid data, because you want to base your rates on the most recent data available and you're multiplying that data by a factor of between 5 and 10 to take into account all the unpaid claims and it creates a very unstable and a very poor way of making rates.

....

If the incurred data was suspect, what I would attempt to do is to fix the paid data based on any information I could obtain. The paid data would be one of the pieces of information I would look at.

6.25 The position of the CAC -- that reliance on incurred losses for purposes of calculating loss development is inappropriate -- rests upon an assumption that the dramatic increase in 1987 incurred losses reflects a recent strengthening of case reserves. Mr. Hunter testified that he believed that such strengthening had

taken place, and indeed stated categorically that there had been case reserve strengthening in the United States. He cited the anticipation by insurers of government interference in Ontario automobile insurance, as well as overall industry profitability and the impact of tax reform, as possible reasons to suspect that such a strengthening had occurred (Transcript, at 2967-91).

6.26 Executives and actuaries from the individual insurance companies that gave evidence before the Board stated that the reserve levels of these companies, which represent approximately 38 percent of the Ontario direct auto premium, were adequate at the time. Witnesses for six of these companies, as well as other witnesses who appeared before the Board, expressed the view that the industry on the whole is under reserved.

b. IBNR Adjustment

6.27 In Chapter 5 of this Decision, reference is made to a discrepancy of some \$716 million between the industry aggregate wide sense IBNR reported by all companies writing Ontario regulated auto insurance under the Board's 1987 Financial Reporting Package (FRP) and that imputed by the IBC based on industry reported known

losses. Evidence adduced on behalf of the IBC indicated that this difference could be reduced to some \$600 million dollars (Exhibit 11.6, at 3; Miller, Transcript, at 2629-35). A number of possible explanations for this discrepancy were put forward in evidence. These are discussed in Chapter 5.

6.28 In estimating loss development, Mercer relied on neither the IBNR figures reported under the FRP nor the IBNR figure imputed by the IBC. Rather, in accordance with the methodology prescribed by the Board, Mercer applied factors derived from historical development patterns to the incurred losses, a process that yielded an implied IBNR number as of December 31, 1987 estimated by Mercer to be \$400 million in excess of the aggregate IBNR number reported under the Board FRP (Bass, Transcript, at 3335; Exhibit 4.11.2).

6.29 On the assumption that the IBNR number reported by the industry under the FRP was accurate, Mercer was requested by Board Counsel to recalculate its rate proposal using the FRP IBNR number rather than the IBNR number implicit in its rate projection. That is, Mercer was requested, in effect, to remove the \$400 million difference from its rate projection. Mercer complied with this request (Exhibit 4.11.2 to 4.11.5,

Exhibit 1), and calculated the effect of the adjustment to be, all other things being equal, a reduction in the average indicated rate change from approximately 35 to approximately 21 percent. Subsequent verification of these figures indicated some downward adjustment to the latter figure.

6.30 Mercer did not endorse this change, and no evidence was adduced concerning the actuarial propriety of such an adjustment. The CAC, however, in final argument, supported this approach as an alternative to Mr. Hunter's use of paid claims to adjust the development factor (Final Argument of the CAC, at 5).

(3) Trend

6.31 The next adjustment to pure premium mandated by the Board methodology is the application of a trend factor. A trend factor is intended to adjust historical losses and allocated loss adjustment expenses to reflect cost levels expected to prevail during the period during which the new rates will be in effect. Accordingly, Mercer estimated an annual trend factor for each coverage.

6.32 In its Decision in Hearing I-88-1B, the Board decided (at 39) that claims cost trending should be based on a combination of (1) the trend of historical pure premium; (2) the trends of historical claim frequency and severity; and (3) the trend of some external factor related to the cost of automobile insurance. The weight to be accorded to each factor was left to be determined in the course of the present hearing.

6.33 In estimating trend, Mercer departed from the Board methodology. Because time did not permit an analysis of an appropriate external factor, a weight of zero was attributed to this component (Exhibit 5.1, at 16). Mercer's treatment of the remaining factors, frequency-severity trend and pure premium trend, is summarized aptly in the Submission of Board Counsel as follows (at 2/39-2/40):

2.100 Mercer stated that frequency was volatile for a number of the coverages, and so it relied on a long term approach to estimating claim frequency trend, rather than the Board's shorter term approach (Exhibit 5.1, p. 15). In her testimony, Ms. Bass indicated that her observations of the change in trend indicated that there was a longer cycle to frequency trend and so she changed the trend model to incorporate ten years of frequency data (Transcript: Vol. I, p. 150). The severity component of the trend remained the same as the Board's methodology. Because short-term frequency was omitted from

the Mercer trend model, short-term pure premium trend was also omitted since one component of the pure premium is frequency.

2.101 The absence of data valued as of 15 months caused a further departure from the Board methodology. Board trend methodology bases the trend analysis on claim data valued as of 15 months. Since this was not possible, Mercer selected an alternative approach. It noted that data valued at 12 months was too immature to form the sole basis of the trend analysis. The alternate model relied instead on a combination of trend obtained from claim data valued as of 12 months and trend obtained from claim data estimated on an ultimate basis.

2.102 Mercer then developed a revised trend model, which it applied to all coverages uniformly. Ms. Bass stated that in doing this she applied actuarial judgment in a uniform rather than in an arbitrary fashion (Transcript: Vol. I, p. 153). This model relies on a combined short-term severity and long-term frequency analysis. The long-term pure premium trend and the severity trend updated through June 1988 form the basis for validating the revised trend (Exhibit 5.1, p. 17).

6.34 The industry generally accepted, as reasonable in the circumstances, the Mercer modifications to the trend methodology adopted by the Board. Counsel for the Industry Coalition was careful to point out, however, that the result of these modifications was to lower the trend factor, and hence the indicated overall rate level, substantially (Howard, Transcript, at 772-76; Written Submission, at 9).

- 6.35 In its written evidence, the CAC accepted the annual trend factors selected by Mercer as "marginally acceptable" (Exhibit 22.1, at 12), although Mr. Hunter expressed concern about the use of any trend factor for frequency in light of the highly unstable nature of the data.
- 6.36 The CAC did object, however, to the trend period selected by Mercer for six month policies. The CAC took the position that six month policies should be trended for nine months beyond the effective date, rather than the one year period appropriate for one year policies. In the absence of evidence concerning the incidence of six and twelve month policies, the CAC assumed a 50/50 split and recommended that the overall trend period be shortened by one and one-half months (Exhibit 22.1, at 12-13; Final Argument of the CAC, at 6-7).
- 6.37 While Mercer's response to the volatility of the claim frequency data was to regard frequency over a long-term, as opposed to a short-term, basis, it noted that an alternative approach to the same phenomenon had been adopted by the IAO. In its most recent advisory rating program, that organization had excluded frequency trend

entirely because of observed volatility and had relied solely on severity to estimate trend.

6.38 In response to a request by Board Counsel, Mercer recalculated its rate projections to eliminate the frequency component of trend. The result of this adjustment, all other things being equal, was to reduce the indicated average rate level increase from 35 to 30 percent (Exhibit 4.11.2 to 4.11.5, Exhibit 1).

6.39 Mercer did not endorse this change, nor did the Industry Coalition. The CAC, in final argument, recommended the elimination of the frequency component of trend because of the data volatility (Final Argument of the CAC, at 6).

(d) Unallocated Loss Adjustment Expense

6.40 The rate making methodology established by the Board includes a provision for unallocated loss adjustment expenses (ULE) calculated as a percentage of incurred losses plus allocated loss adjustment expense. Once again, in estimating an appropriate ULE provision, Mercer was faced with data availability limitations.

As there is no source of aggregated expense data for Ontario private passenger automobile, Mercer was forced to rely on data available under the Automobile Direct Expense Report (ADER) of the IBC, a survey in which insurers participate on a voluntary basis. While participants represent over half the Ontario insurance market, and while expense information is provided separately for Ontario, it is not restricted to Ontario regulated lines; nor does the ADER differentiate among categories of insurance or coverages (Exhibit 5.1, at 18).

6.41 Mercer's derivation of the ULE provision, 7.1 percent, is outlined in Exhibit 84 to Exhibit 5.1, and is summarized in the Submission of Board Counsel as follows (at 2/10):

2.21 Mercer based its estimate on the ratio of ULE to direct written premium from the ADER for Ontario. Mercer converted this ratio to dollars and then to a ratio of ULE to incurred losses plus allocated loss adjustment expense. Since the ADER does not differentiate among categories of insurance or coverages, Mercer applied the resultant total automobile insurance ULE ratio to private passenger automobile.

6.42 The CAC took the position that, as long-term expense trends are down, the latest year of experience should be selected for the ULE and that, accordingly, Mercer's

ULE ratio of 7.1 percent should be reduced to 7.0 percent (Exhibit 22.1, at 13).

(e) Catastrophe Provision

6.43 In its Decision in Hearing I-88-1B, the Board decided (at 50) that, for purposes of rate making in the early years of the Board's operation, judgment should be applied to accident year data to determine whether it contains catastrophe claims. The current IAO catastrophe factor of 2 percent should then be applied to the data, as adjusted to remove catastrophe claims.

6.44 In accordance with the Board's Decision, Mercer examined information provided by the IBC with respect to natural catastrophes and determined that none had occurred in Ontario in 1986 or 1987. The 2 percent IAO catastrophe factor was then utilized for comprehensive coverage (Exhibit 5.1, at 32).

(f) Rate Group Drift

6.45 The Mercer Proposal contained no separate provision to reflect rate group drift, as Mercer was advised by the Vehicle Code Service (VCS) that its methodology for determining future rate groups incorporated an

adjustment for this factor. Because the VCS Report to the Board was not available to Mercer prior to completion of its rate proposal, Mercer was unable to examine the VCS methodology. Accordingly, Mercer neither accepted nor endorsed the VCS estimation of rate group drift (Exhibit 5.1, at 27).

6.46 Mercer did recommend, however, that "because [rate group drift] includes some aspects of projection, rather than technical establishment of relativities, ... future analysis of rate group drift [should] be separated from the VCS's analysis of rate group relativities and returned to the normal rate making process" (Exhibit 5.1, at 27-28).

6.47 The CAC took the position that the VCS methodology does not incorporate an adjustment for rate group drift (Exhibit 22.1, at 13; Hunter, Transcript, at 3431-33), and accordingly eliminated the trend factors from both comprehensive and collision to offset for this failure.

6.48 In the course of examination by the Board, Ms. Bass stated that, having heard the oral evidence of the VCS, she believed that the VCS methodology did in fact contain an adjustment for rate group drift, as it

estimated future, rather than current, distribution of automobiles by rate group. Ms. Bass emphasized, however, that she had not reviewed the methodology to determine the appropriateness of the adjustment for rate group drift (Transcript, at 3745-49).

(g) Premium Variable Expenses

(1) Acquisition Costs

6.49 In its Decision in Hearing I-88-1B, the Board determined that the rate making methodology should reflect the current treatment of commissions and salary payable to brokers and agents. Accordingly, the Mercer proposal contains a provision to reflect current acquisition expenses.

6.50 The 1986 and 1987 average acquisition expense for both agent/broker and direct writing companies, as estimated by Mercer from the IBC ADER, is 14.1 percent. Based upon information received pursuant to a special call to insurers, Mercer increased this figure to 14.3% to reflect higher operating costs for private passenger automobile vis-à-vis the average for all automobile (Exhibit 5.1, at 85-86, and Exhibits 85 and 89 thereto).

(2) Premium Taxes

6.51 Premium taxes were included in the Mercer Proposal at the statutory rate of 3 percent (Exhibit 5.1, at 86).

(3) OHIP Provision

6.52 In accordance with the rate making methodology established by the Board, Mercer included in the third party liability pure premium a provision to reflect the amount paid to OHIP by insurers as reimbursement for costs incurred by OHIP for services to insureds suffering personal injury. As the current OHIP charge of 2.4% is calculated as a percentage of third party liability premium, which includes expenses, Mercer converted this figure to 2.5% to reflect the different treatment of expenses under the Board's methodology (Exhibit 5.1, at 86-87).

(4) Underwriting Margins

6.53 The underwriting margins established by the Board in its Decision in Hearing I-88-1C (and hence, implicitly, the ROE of 12.5% established by the Board in that

Decision) were utilized by Mercer without further analysis (Exhibit 5.1 at 87; Bass, Transcript, at 73).

(5) Contingency Provision

6.54 In its Decision in Hearing I-88-1B, the Board approved the inclusion in the rate making methodology of an explicit contingency provision to offset for systematic bias. It expressed doubt, however, that such a provision could be established on an industry-wide basis in the early years of rate making (Decision, at 71-72). The Mercer Proposal incorporated a provision for contingencies or systematic bias of zero (Exhibit 5.1, at 87). No attempt was made by the industry to establish that this provision should be in an amount other than zero for purposes of the present rate making exercise (see State Farm Argument, at 8).

(h) Exposure Variable Costs

6.55 In its Decision in Hearing I-88-1B, the Board decided (at 54) that certain non-claims related general operating expenses of an insurance company, such as those associated with underwriting, policy issuance, occupancy, and general administration, should be dealt with by way of an expense constant rather than be

permitted to vary directly with premium. The Board decided that, at least for the inaugural rate setting process, these expenses should be charged to purchasers on a per exposure basis.

6.56 In estimating the exposure variable costs, Mercer relied on data from the IBC ADER, as well as information obtained from a special call to insurers. The process of estimation employed is outlined in Exhibit 5.1, at 87-92 and Exhibits 88-91 thereto, and is summarized in the Submission of Board Counsel as follows (at 2/15):

2.34 Mercer estimated the exposure constant by first determining the historical ratio of underwriting, policy processing and a share of related general administration expenses to direct written premium. These were converted to dollar amounts and then indexed to the expected cost level of 1989 through the use of certain indices as the average weekly salary index, the printing cost index and the composite industry product price index of Statistics Canada plus the annual rent costs as reported in the TRAC report.

2.35 The anticipated 1989 expenses of the Board were then added to these expense costs. The final expense constant was determined by dividing these aggregate costs by the number of exposure units and then including the provision for variable costs.

As a result of this process, Mercer arrived at an expense constant per exposure of \$46.

- 6.57 The CAC differed from Mercer in a number of respects, to arrive at an expense constant of \$43 per exposure (Exhibit 22.1, at 16-17). On the ground that long-term expense trends are down, the CAC selected only the 1987 automobile expense ratio of 4.9%, rather than Mercer's 5% figure which was based on an average of 1987 and 1986. Moreover, the CAC shortened the period by 6 months and selected an annual fixed expense trend of 4.5%, as opposed to Mercer's 5.8%.
- 6.58 With respect to the proposed inclusion of provision for 1989 Board costs, it was suggested that provision should also be made for the 1988 costs of the Board, which would be assessed to insurers, and presumably passed on to the insurance-buying public, in 1989 (Final Argument of Safeco, at 2).
- 6.59 It was also suggested that provision should be made to cover the one-time costs that would be incurred by companies in converting to the new classification and rating systems of the Board. Safeco presented written evidence that quantified that company's one-time conversion cost at \$5.80 per automobile (Exhibit 12.3, at 1-7), and urged the Board to investigate the costs

of conversion and to incorporate them into the expense constant (Transcript, at 1671-77).

6.60 Ms. Bass expressed the view in cross-examination that such costs would have to be separated from the cost that usually attends rate level changes, as this is an historical expense that is captured in the expense data. She stated, however, that such costs, if separable, significant, and quantifiable, should be recognized (Transcript, at 757-60). When recalled for re-direct examination, Ms. Bass suggested that a company's cost of conversion might be estimated and accommodated within the range of rates established by the Board. If this were not possible, a deviation application might be brought by the company (Transcript, at 3374-75).

B. OTHER CONSIDERATIONS

6.61 In addition to actuarial evidence concerning the appropriate overall rate level, the Board heard evidence and argument raising other matters relevant to its obligation under section 20(4) of the Act to establish rates that are "just and reasonable and not excessive or inadequate".

1. Efficiency

- 6.62 In accordance with the methodology prescribed by the Board in its Decision in Hearing I-88-1B, Mercer used industry average expenses to establish the premium variable expenses and expense constant for use in setting the overall rate level. The CAC took the position that the use of industry average expenses to establish benchmark rates encourages inefficiency among insurers, and suggested that the Board make a clear public policy choice in favour of efficiency by establishing the benchmark rates below the level indicated by the use of average industry expenses (Exhibit 22.1, at 15; Final Argument of the CAC, at 8-9).
- 6.63 The CAC witness, Mr. Hunter, identified two methods whereby efficiency might be encouraged. First, the Board could establish benchmark rates at the "average competitive level". Alternatively, and preferably, the Board could "establish rates at a level of maximum competitive force", thereby excluding inefficient insurers (Exhibit 22.1, at 15-16; Transcript, at 2886-90).

- 6.64 The first method, the "market competitive model", would involve a calculation of the actuarially indicated rate and a reduction of that rate by a percentage figure to reflect market competition. Mr. Hunter suggested a reduction of 7.5%, calculated with reference to the mid-point in the range of rates (+10% to -25%) suggested by Mercer to accommodate market dispersion.
- 6.65 The second, "fully competitive model" approach, would calculate the benchmark rates with reference to those charged by a real, or hypothetical, "efficient" company and would require deviations upward from that level. Mr. Hunter estimated very roughly that the Mercer average variable expense levels could be reduced by 12 percentage points to reflect efficient expense levels and capitalization (Exhibit 22.1, at 20, and Exhibit C thereto).
- 6.66 Mr. Hunter stated that he expected most insurers to apply to adopt the average, actuarially indicated rate. While upward deviations based upon expenses should, in his view, be relatively easily approved, actual proof of need of a level above the Board-established efficient rate level should be required. Moreover, the Board should publicize deviation levels sought by

insurers in order to encourage efficiency (Exhibit 22.1, at 20-21).

6.67 A number of objections were raised by industry representatives to the approaches suggested by Mr. Hunter as means of encouraging efficiency. It was suggested that the need to review requests for deviations would impose heavy burdens upon the Board. It was further argued that the proposal would encourage "creaming" and would discriminate against companies that accept higher risks with the attendant higher underwriting and loss adjustment expenses. It was also pointed out that the provision in the rate making methodology for total expenses (expense constant and variable expenses) was insufficient to permit a reduction of up to 12 percentage points (State Farm Argument, at 6; Cross-examination of Mr. Hunter by Counsel for the Industry Coalition, Transcript, at 3450-63).

2. Affordability

6.68 The Board also heard evidence, from members of the public as well as from the CAC and representatives of the New Democratic Party and the Progressive

Conservative Party, concerning the impact of the rate proposal on consumers.

6.69 It would be an understatement to say that the major concern of the public participants in the hearing with respect to the overall rate level proposed by Mercer was affordability. As discussed in more detail in Chapter 4, members of the public voiced grave concern about the impact of the proposed increases on their ability to continue to operate their automobiles. It was stressed that, in today's environment, operation of a car is not a luxury, but rather a necessity for access to the workplace and to such services as, for example, medical care for elderly or infirm family members. The view was strongly expressed that, automobile insurance being compulsory, it should be affordable. Many members of the public feared that the proposed increases would force drivers to give up their cars, or to drive uninsured, with serious social and economic consequences.

6.70 Representatives of both the New Democratic Party and the Progressive Conservative Party stated that the Board, in setting rates, should take into account considerations of affordability to consumers (Submission of R.W. Runciman, MPP, Ontario Progressive

Conservative Party Critic for Financial Institutions, Exhibit 3.27(a); and Submission by Bob Rae, MPP, Leader of the Official Opposition, and Peter Kormos, MPP, New Democratic Party Critic for Auto Insurance (January 13, 1989)). The Submission of the New Democratic Party referred (at 1-3) to statements by the then Minister of Financial Institutions in announcing the legislation establishing the Board, and took the position that the primary purpose of the legislation was to protect the interests of consumers. The Submission stated as follows (at 6,7):

The Board must interpret the words 'just and reasonable and not excessive or inadequate' in light of the original purpose of the legislation, the protection of the interest of the consumer.

....

An unaffordable rate is neither just nor reasonable. Nor is a rate which will force people to stop driving; nor is a rate which will increase the number of drivers who drive, illegally, without insurance.

6.71 The CAC, for the most part, confined its explicit affordability arguments to the classification differentials proposed by Mercer. These arguments are dealt with in Chapter 7. In light of his experience before American bodies that regulate insurance under

mandates similar to that governing the Board, Mr. Hunter was asked to comment on the Board's ability to depart expressly from an actuarially indicated rate on the basis of affordability (Transcript, at 2937-41, 3571-73). Mr. Hunter acknowledged the difficulty of the problem, stating, "One of the reasons I didn't make an express provision for an affordability factor, it's very difficult to do it within those constraints. My proposals about affordability relate to relativities ..." (Transcript, at 2938). Indeed, Mr. Hunter stated, in cross-examination by the Board, "I don't ever advocate a rate that is inadequate" (Transcript, at 3619). Apart from the possibility of transitional programs, whereby large increases are phased in with the support of insurers, and the suggestion that the Board "work very closely with insurers right now" to keep insurance affordable (Transcript, at 3572), Mr. Hunter could offer little assistance to the Board on this issue.

6.72 Rather than challenge the overall rate proposal expressly on affordability grounds, the CAC, as outlined in previous sections of this Chapter, concentrated its efforts on challenging the proposed rates as excessive on actuarial grounds. In addition, the CAC suggested that the Board make a policy choice

in favour of insurer efficiency by setting benchmark rates below the actuarially indicated level.

3. Companies' Evidence - Adequacy and Historical Pricing Decisions

6.73 Two of the issues identified in the Issues List (Appendix C) were as follows:

- . How have pricing decisions been made historically at the company level?

- . What effect, if any, do historic pricing decisions have on the Mercer Proposal?

6.74 During the hearing, the Board heard evidence on these, and other, matters presented by witnesses for seven insurance companies selected as being representative of the Ontario automobile insurance industry. In 1987, the seven companies in question - Safeco, Pilot, State Farm, Allstate, Dominion, Royal, Co-operators - wrote 38 percent of the direct premium written in the Province.

6.75 The evidence presented to the Board by these companies covered a number of topics, including the rate change

required by each company on the basis of both its own, and the Board's, rate making methodologies. In addition, the companies were asked to describe the process whereby prices were established.

6.76 The evidence of the companies with respect to their pricing process is summarized in the Submission of Board Counsel as follows (at 7/5):

7.14 Generally the pricing process was described as consultative in nature with input from a number of individuals. The companies agreed that representatives of the actuarial, marketing, underwriting, claims and financial departments provided input to the decision. The ultimate pricing responsibility rests with the CEO of the company.

7.15 The pricing process outlined did not vary significantly by company. Generally the actuarial department provided an indication of required rates based on past experience. The underwriting and claims departments indicated changes in their books of business or claims experience which required a change in rates. A key input to the process was provided by the marketing department. They assessed the market environment and actions of their competitors.

6.77 Without exception, the companies indicated that actuarial adequacy is but one factor in the pricing decision in any given rating period, although actuarial adequacy over the long term is an obvious goal. Competitive considerations and the impact of rate

changes upon their customers ("rate shock") were other important considerations relevant to the pricing decision. This is borne out by the history of pricing decisions in the face of inadequacy in the years immediately prior to the April, 1987 government rate freeze, as disclosed by the companies' written responses to questions posed by Board Counsel. (See responses to questions E, E(1) and E(2), in Exhibits 12.2 (Safeco); 14.1 (Pilot); 15.1 (State Farm); 16.1 (Allstate); 19.1 (Dominion); 20.1 (Royal); and 21.1 (Co-operators).)

6.78 Five of the seven companies' rates were substantially inadequate at the time of the freeze; a sixth company (Co-operators) believed at the time (erroneously as it transpired) that its rates were adequate. The rates of the seventh company, Pilot, were adequate; Pilot had taken increases totalling in excess of 30 percent in the 17 months leading up to the freeze.

6.79 Notwithstanding severe rate inadequacy, none of the five companies had taken rate increases in amounts sufficient to cure the existing inadequacy. For example, while Safeco had taken four semi-annual rate increases in the 18 months prior to the freeze, for a cumulative total increase of 45.1%, it had kept each

increase to around the 10% level "to minimize the impact to the consuming public". As a result, a rate increase of 42.7% would have been necessary to achieve adequacy as of April, 1987 (Exhibit 12.2, at 8). State Farm, with an actuarially indicated rate increase of 23.8% as of February 1, 1987, took only 8.5%, because of the need "(a) to maintain a competitive rate in Ontario, and (b) to avoid large increases to our policyholders" (Exhibit 15.1, Item E(1)). The evidence of the other companies caught with existing rate inadequacy by the freeze also indicated that competitive forces or the reaction of their insureds, or both, had prevented them from taking the rate increases necessary to achieve adequacy. The companies indicated that their intention, in an unregulated environment, was to proceed in stages towards adequacy. When asked whether, if a 35 percent rate increase were approved by the Board, they would take advantage of the full increase, no company indicated that it would increase rates by that amount at one time.

6.80

The companies' present actuarially indicated rate increases, utilizing the Board's rate making methodology, were calculated to be as follows: Pilot: 5%; Co-operators: 17.3%; State Farm: 21%; Royal: 26.2%; Allstate: 29.2%; Dominion: 37.1%; and Safeco: 41.5%.

The indicated rate changes utilizing the companies' internal rate making methodologies were, with one exception, higher.

6.81 In its final argument, the CAC took the position that, in considering what constitutes reasonable rates for the industry, the Board should take historical pricing decisions of the industry into consideration (Final Argument of the CAC, at 30-31).

4. Jurisdiction of the Board

(a) Introduction

6.82 The duties and powers of the Board are derived primarily from the Act. The principal duty of the Board is provided in section 20(1) (emphasis added):

Upon classes of risk exposure being prescribed for a category of automobile insurance, the Board, following an industry-wide hearing, shall set a rate or range of rates with respect to each such class of risk exposure.

The Act also sets standards for the Board to follow in carrying out its principal duty and these standards are expressed in section 20(4) (emphasis added):

In setting a rate or range of rates, the Board shall set a rate or range of rates that in the opinion of the Board is just and reasonable and not excessive or inadequate.

As the Board is setting industry-wide rates under the Act for the first time, the standards imposed on the Board are being applied for the first time. The Board considers it prudent to consider, in general terms, its approach to these standards. The Board notes that the Act provides that it has "exclusive jurisdiction ... to determine all questions of fact or law that arise in any matter before it..." (section 14(1)).

6.83 The Board has been given various powers which are relevant to the exercise by the Board of its statutory duties and it has "exclusive jurisdiction to exercise the powers conferred upon it by or under this Act" (section 14(1)). The most important of these, in the context of an industry-wide rate hearing, are as follows:

- . The Board may exercise such powers and perform such duties as are necessary to carry out its functions under the Act including the conduct of any inquiry or inspection it considers necessary before or during a hearing (section 12(1)(c));
- . The Board may consider any financial or other matter directly or indirectly affecting rates (section 20(7));

- . The Board shall adopt the most expeditious method of determining the questions on the merits arising in any proceeding (section 11(1)); and,
- . The Board may express the rates in dollar terms or in such other manner as the Board considers appropriate so that a person may determine the rate for each class of risk exposure (section 20(3)).

It will be noted that the Act is silent about the timing of the exercise of the Board's duties and powers with respect to industry-wide rate setting. In this first effort, the Board had to contend with an immoveable deadline which, in turn, forced the pace of the first industry-wide hearing. The deadline is June 1, 1989 and it arose because the Lieutenant Governor proclaimed that day as the one on which section 33(1) of the Act -- prohibiting insurers from differentiating or making a distinction, exclusion or preference in a contract of automobile insurance on the basis of age, sex, marital status, family status or handicap -- comes into force (section 33(2)). Further, this impending prohibition created a set of arguably unique circumstances which are occurring contemporaneously.

6.84 Many participants in this part of the Industry-Wide Hearing chose not to present legal argument on the standards to be applied by the Board in meeting its

statutory duty. Board Counsel presented the most extensive written submissions, as well as oral submissions. Oral argument on this broad issue was presented, based on written submissions, by Mr. Howard (for the Industry Coalition), Mr. Baggaley (for the CAC), Mr. Rae (for the Ontario legislative caucus of the New Democratic Party) and, in the course of the hearing, Mr. Runciman (for the Ontario Progressive Conservative Party, Exhibit 3.27(a)). Limited arguments were made on behalf of three insurance companies (State Farm, Economical Mutual and Pafco). The major submissions and arguments will be summarized. The Board hopes that, in attempting to extract some understanding from these submissions and arguments, it has not done a disservice to the views of the participants advancing them.

6.85 It is unlikely that the statutory standard -- just and reasonable and not excessive or inadequate -- has been used in other statutes (in Canada or otherwise), and therefore the Board was not provided with any judicial interpretation of determinative force. There generally are two types of statutes that might, in some circumstances and for some purposes, be analogous to the Act, with the result that the judicial interpretation of them might be helpful. These are the

statutes governing rate setting for public utilities and those - exclusively American - governing rate regulation of insurance companies. The degree to which interpretations of these statutes are useful was disputed at the hearing. Parties also looked to other sources for assistance, as will be outlined below.

(b) Approaches to Interpretation

(1) Board Counsel

6.86 Board Counsel made two principal submissions, which are companions. The first is that, although the Board has a very broad scope as to the issues and facts it may consider in setting rates, the rates themselves must meet the statutory standard (British Columbia Electric Railway Co. Ltd. v. The Public Utilities Commission of British Columbia et al., [1960] S.C.R. 837, at 856; Transcript, at 3838). The second is that although the statutory standard itself is "extremely wide" (Transcript, at 3841) and "necessarily, intentionally and appropriately vague" (Submission, paragraph 14.6), the discretion of the Board is subject to limits, or boundaries, which are either implicit or explicit in the statutory standard (Submission, paragraphs 14.7, 14.8, 14.18; Transcript, at 3844-46).

6.87 Although it was not put strictly in the following terms, the submissions of Board Counsel suggest that the core of the statutory standard is the phrase "just and reasonable", and that the phrase "not excessive or inadequate" is an iteration, for greater emphasis, of the limitations implicit in "just and reasonable" (Transcript, at 3845).

6.88 Mr. Champion, in submissions given orally, stated (Transcript, at 3844-45, based on the cases cited in the Submission, paragraphs 14.11 - 14.13, inclusive):

Dealing with 'just and reasonable'. In my respectful submission the central concepts are two-fold. No. 1, you must give the industry an opportunity to earn a fair rate of return. I stress it is not a guarantee, it was never meant to be a guarantee, and it may be that the industry as a whole because of the competitive forces will never earn 12.5 per cent return. But it is your obligation to give it, if you fixed it at 12.5 per cent, to give them an opportunity to earn it.

But at the same time, the second focus always must be, that the public must be protected from excessive rates. That is both contained in the notion of 'just and reasonable' and is obviously expressly stated in the notion of 'not excessive'. It is there twice. And, in my respectful submission, those can be very competing variables and you have to find the proper balance.

Mr. Campion observed that these concepts were drawn from the law governing public utilities, which generally are monopolies, but that they are relevant to a competitive industry (Transcript, at 3846).

6.89 Looking to American jurisprudence involving either public utilities or insurance companies, Board Counsel gave examples of how the words "excessive" and "inadequate" have been interpreted (Submission, paragraphs 14.14 and 14.15, respectively).

6.90 The following themes are apparent from the cases on whether rates are excessive:

- . there should be a relationship between the class of risk, the services rendered, the coverage provided or the competition for the class of risk and the rates;
- . the efficiency of companies is relevant to rates in that rates should not function so as to ensure that inefficient companies will make a profit and efficient companies will make excessive profits;
- . rates can constitute an incentive to good management; and,
- . the profit to be generated by the industry as a whole must be considered.

6.91 The following themes are apparent from the cases on whether rates are inadequate:

- . the most efficient companies should not be the measure;
- . if the high risk pool grows rapidly or if competition is reduced, rates are inadequate; and,
- . if insurers can only operate at a loss, cannot pay claims, withdraw or become insolvent, rates are inadequate.

Board Counsel submitted that the Board decision did not have to address the needs of every insurer because there is a deviation procedure available. Some withdrawal of capacity is expected and, he implied, can be withstood given existing conditions of capacity and competition in the OAI (Submission, paragraph 14.18).

6.92 It is obvious that affordability has not been regarded as a statutory standard in rate-setting in the decided cases presented by Board Counsel. Board Counsel made several submissions with respect to affordability (Submission, paragraphs 14.4 and 14.5):

- . the Board may consider evidence of affordability for consumers generally, not individually;
- . it is difficult to lead evidence with respect to affordability generally;
- . if rates give the opportunity to earn a fair rate of return but are not considered to be generally affordable, then the Board must exercise its

discretion within the limits of the statutory standard and select rates which give the opportunity to earn.

Mr. Campion expanded upon the last, important, point in oral submissions (Transcript, at 3839-40):

If I am correct that that clause allows you to look at things like general affordability and which I submit it does, the question then is: How do the two fit together if, for instance, the rates are not generally affordable but also not just and reasonable at the same time? Do you have to go to just and reasonable? In my respectful submission you do.

But, on the other hand, within the range of just and reasonable, as you consider it appropriate, you may wish to choose the low end of the range by considering factors which are contemplated in Section 20(7). So, for instance, general affordability, if proved - and I grant you it is a very difficult thing to prove - would be a basis for saying: I am choosing the low end of what is just and reasonable.

So if you had a range of - and I am not talking about range of rates, I am just talking about what you think the benchmark ought to be - you said: I think that the benchmark could be anywhere between a 35 per cent increase and a 10 per cent increase, then on the issue of general affordability and all those rates in between were just and reasonable you could say: I am taking the low end. So I think that is how those two sections interrelate. In the end, though, they must be just and reasonable....

6.93

Mr. Campion was of the view that the Board should avoid the temptation to take a definitive position on the

meaning of the statutory standard, as the Board should always have available to it the "widest possible discretion" (Transcript, at 3842-43):

As time passes, circumstances change and these words are vague so that you can capture changed circumstances and conditions as this Board moves from the first set of hearings to future years.

In addition, you are required to regulate a complex and competitive industry. It is driven by competing desires of a number of groups who have an interest in its success, its stability, its efficiency, its profitability, its low prices where profitable and driven - and I think this is significant - by market forces which are both known and unknown.

(2) The Industry Coalition

6.94 In Mr. Howard's view, the starting point for interpretation of the statutory standard is the words "reasonable and not excessive or adequate." He noted that the Casualty Actuarial Society Principles state: "a rate is reasonable and not excessive, inadequate or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer" (Written Submission, paragraph 44). He argued therefore that the statutory terms are "terms of art", and that the legislature intended them to be interpreted in their

technical sense (Written Submission, paragraph 45; Transcript, at 3888-89). Mr. Howard confirmed that the legislative record of the Act had been reviewed but that the record did not include any specific references to support this interpretation (Transcript, at 3889-90).

6.95 Mr. Howard addressed the role of the operation of the statutory standard of "just" in oral argument and in response to questions from the Board. In his view, the Board must first determine what the actuarially indicated rate is, and then the Board can adjust the rate, in its discretion, to arrive at a just result (Transcript, 3874-75). He elaborated on both of these steps.

6.96 In determining the actuarially indicated rate, the Board is limited to considering evidence of an actuarial nature, that is, it cannot consider positions with respect to the rates that are not actuarially based (Transcript, at 3873-74, 3881, 3885-86). Given that two actuaries -- Ms. Bass and Mr. Hunter-- produced actuarially indicated rates that were significantly different, Mr. Howard was questioned about the implications of his interpretative approach

for this divergent actuarial evidence. He stated
(Transcript, at 3893, 3895, respectively):

... all I am saying to the Board is, you have to be satisfied which is the more careful, which is the more reasonable. And you can select either one and say that's the one we are going to select.

What I do say to the Board is, you can't pick something in between just to saw the thing off

....

The whole point of my submission with respect to the technical language of the statute is you have the right and the power to adjust the consequences, but in this regulatory process, in my submission it shouldn't be Mr. Campion and it shouldn't be me, and with great respect it shouldn't be the Board, that are making actuarial judgments.

You listen to the actuaries. You assess which one you have the most confidence in for this time....

6.97 In Mr. Howard's view, the Board's jurisdiction with respect to the standard of "just" may be broader even than that contemplated in Mr. Campion's approach to "just and reasonable". Mr. Howard said (Transcript, at 3891):

... in my submission, it's clear that if this Board considers that it would be unjust at this time to require the rates to be paid to achieve the ultimate desire, then you have the power to say no....

It turns on what is just to all the interests concerned.

... Those include not only the industry, but also the public and the public interest in avoiding chaos, if you like. Lord knows we are going to have enough chaos with the change in the Class Plan.

The reference to the "ultimate desire" in this quote is presumably a shortened version of an earlier reference to "the desirability of ultimately affording an opportunity to get to 12.5 [ROE]" (Transcript, at 3885).

(3) The CAC

6.98 The CAC took a straightforward approach to the interpretation of section 20(4). The CAC sees it as a direction to balance the interests of consumers and insurers as follows (Final Argument, at 30):

The terms 'just and reasonable' can be applied to the interests of both consumers and insurers; the term 'not excessive' is intended clearly to protect the interests of consumers and ensure that premium increases are reasonable, while the term '[not] inadequate' is intended to protect the interests of insurers and give them an opportunity to earn a fair rate of return.

6.99 In Mr. Baggaley's view, the Board is not compelled to adopt an actuarially indicated rate and he argued that

the Board would be exceeding its jurisdiction if it did so because rates might be "excessive". He recommended that the Board establish benchmark rates below the actuarially indicated level. This would serve as a control on the excessive rates that some better positioned or more efficient companies might earn, while allowing other companies to operate successfully somewhere within the range. Mr. Baggaley pointed out that, under the Act, insurers can seek adequacy either through positioning in the range or through a rate deviation application, while consumers have no direct remedy against excessive rates (Final Argument, at 31-32).

(4) The NDP

6.100 The heart of the argument put by Mr. Rae to the Board is that the statements of members of the Government of Ontario -- the public record as well as the legislative record -- in respect of the Act establish that the Act is to be interpreted in the interests of consumers (Submission, at 4, 6; Transcript, at 3897-900), and consumers alone (Submission, at 3).

6.101 Mr. Rae did not suggest that the Board should apply this standard to the evidence in this hearing. He took

the view that the Board did not have before it the proper evidence. It was the view of his caucus that, in particular, the Decision of the Board in Hearing I-88-1C (on profitability standards) prevents the Board in any event from selecting rates that are "just and reasonable" (Submission, at 8). In Mr. Rae's view, the Act is "not an exercise in profit insurance" (Submission, at 6). The Board should "make a quite different determination in how Ontario's insurance industry should be run" (Submission, at 4). The relevant evidence would be (Submission, at 6):

... on the efficiency of the industry, on its overhead and administrative and litigation costs, on who drives and why they drive, and what is 'affordable' and 'adequate' from the point of view of the consumer.

6.102 The implication of this argument is that the Board should determine what overall system of providing automobile insurance is in the best interests of the consumer, and then set rates on that basis. Mr. Rae made it clear that he and his caucus support public, non-profit automobile insurance (Transcript, at 818; Submission, at 1). The NDP proposal goes well beyond Mr. Hunter's proposal that, to encourage insurer efficiency, benchmark rates be set at the "average

competitive level" or the "level of maximum competitive force" (paragraph 6.63 above).

6.103 The NDP implies, but does not openly state, that the Board should largely or entirely disregard profit with respect to automobile insurance, including the opportunity to earn (Transcript, at 3914). It is stated (Submission, at 3):

Strictly speaking, nothing in the Act says specifically that any insurance company is entitled to a fair return on equity.

In the Submission, the NDP referred (at 4) to the "extraordinary profitability of all other aspects of the insurance business ... according to the Board's own figures ... 26.89 percent for 1987". In response to a question from the Board, Mr. Rae stated that the term "not ... inadequate" refers to "the interests of the industry" (Transcript, at 3919-21).

6.104 Mr. Rae argued, as did the CAC (paragraph 6.97), that the Board would exceed its jurisdiction if it determined that it must accept the actuarially indicated rate, which he stated to be "[the rate] exclusively based on the interests of the industry as defined by what it needs to make the return on

investment that it thinks fair or that you [the Board] determine is necessary ..." (Transcript, at 3904). In Mr. Rae's view, Ms. Bass interpreted section 20(4) in a strict, actuarial sense, "in other words, from a strict point of view of the industry" (Transcript, at 3907).

6.105 Mr. Rae was questioned by the Board concerning whether the Board had jurisdiction to adopt a rate or range of rates that did not generate enough money to pay claims (that is, the adjusted pure premium is not adequate) but that might meet some standard of "affordability". In Mr. Rae's view, the Board can only adopt the "affordable" rate, and any shortage of money in the system (Transcript, at 3918):

... is a problem of the insurance industry and the government, that is not your [the Board's] problem.

(5) The PC Party

6.106 Mr. Runciman suggested that the Board use its jurisdiction to ensure the type of insurance system that the P.C. Party considers most desirable. In this case, Mr. Runciman was of the view that the Mercer Proposal should be rejected (Exhibit 3.27(a), at 8). It therefore was suggested, by implication, that the

Board should refuse to set rates and, further, it was explicitly suggested that the Board should recommend its own abolition or at least the revocation of its rate setting powers (Exhibit 3.27(a), at 13-14). In the view of this limited intervenor, "the free market, which is driven by the informed choice of millions of consumers, can best set a fair price" (Exhibit 3.27(a), at 1).

6.107 Mr. Runciman argued that, if the Board is to set rates, consumer interests must remain paramount, and that rates should be affordable even if some companies do not earn adequately (Exhibit 3.27(a), at 2). He stated (Exhibit 3.27(a), at 14-15):

... the recommended increases should be rejected because there has been no consideration of whether or not they are affordable for the consumer. Surely, affordability for the consumer should be as much a determinant of fairness as the adequacy of rates for insurance companies.

If the proposed rates were rejected, capping or phasing in was recommended.

6.108 Mr. Runciman expressed several times his concern that stability may be achieved but that competition will be

reduced by "inhibiting innovation", resulting in the withdrawal of capacity from the market place (Exhibit 3.27(a), at 9, 11). Mr. Runciman may not have contemplated the availability and efficacy of a range downward from the benchmark rate.

BOARD DECISION

1. The Job of the Board

6.109 The Board's understanding of its jurisdiction is based on an opening premise: that the job of the Board is to set industry-wide rates, and to review such rates from time to time. Many in this Province hold a personal view as to whether the Board should have been established, or should have been established in the way that it was, and the Board heard many of these views in the hearing. It is likely that such broad political debate will continue, increasing in ferocity from time to time as decisions of the Board are released, and that is as it should be in a lively democracy. The rate setting work of the Board, however, must go on until such time as the Act is amended to alter its duties.

6.110 The timing of the Industry-Wide Hearing has been driven by the regulatory steps mandated by the Act, a point which the Board may not have adequately communicated, but which nonetheless was mischievously portrayed by some. In particular, the timing of this hearing was not manipulated to frustrate public participation. The facts are simple:

- . as of June 1, 1989, mandated by the Act, insurers will be prohibited from classifying drivers on the basis of age, sex, marital status, family status and handicap;
- . the Act requires that a uniform classification system be adopted and that this be done before rates can be set;
- . as a practical matter, most companies process their renewals 60 days in advance of the contract expiry date, and therefore companies had to be in a position to process June 1, 1989 renewals on April 1, 1989; and,
- . as a practical matter, massive systems changes of the type necessitated by the Act could take up to six months prior to April, 1989.

Even with the pace of the first Industry-Wide Hearing and the Decisions of the Board, insurers will be hard-pressed to meet the June 1, 1989 deadline.

6.111 The Board begins its decision making in an insurance environment characterized by a number of fixed camps,

fighting fixed battles. The issues dividing them are major, both because of the number of factors that contribute to the size of premiums and the intractability of the issues. Everyone wants change of some description, but change of any kind will affect some more than others. As is usual whenever there is a will to change something, there are countervailing pressures not to proceed.

6.112 Although the Board is only one of a number of bodies considering automobile insurance matters, the expectations of the role the Board could play in resolving some of the issues and the time frame within which the Board could do so have been high. The Board has high expectations of itself.

6.113 The Board, given the timing pressures and the contentious nature of the issues, deliberately selected certain objectives, apart from the substantive issues, for its first Industry-Wide Hearing. The major objectives were:

- . to develop a fair process in which all interested parties could participate;
- . to break down the myriad issues within the Industry-Wide Hearing so that each part was manageable in scope; and,

- . through evidence initiated by the Board, testing of evidence initiated by others and its own decisions, to make the relevant concepts, processes, data and issues as comprehensible as possible.

6.114 The Board has grappled, to the best of its ability and to the limit of its human and other resources, with the exigencies of the Act. The Board agrees with the need to ensure that the above-noted objectives are well and truly met in each subsequent hearing. The Board supported the inclusion of the Board in Bill 174, the Intervenor Funding Pilot Project Act. In general, the Board will push to find effective and innovative ways to involve the public in the public hearing process.

6.115 In the Board's view, therefore, it was compelled to take steps that would allow rates to be set notwithstanding the lack of lead time and the lack of consensus concerning the problems and their solutions.

2. Choices With Respect to Evidence

6.116 The Board heard argument concerning the appropriateness of the evidence developed by Board Staff for presentation in the Industry-Wide Hearing. Specifically, Mr. Rae, on behalf of the NDP, argued that the Board should not base its decision on the

costs that the industry currently is sustaining, but rather should determine what costs are reasonable and what premiums are affordable. It was Mr. Rae's view that the Board had erred, in Decision I-88-1C, by selecting underwriting margins for use in the proposed rates that were based on an ROE of 12.5 percent. He appeared to hold firmly to the view that the underwriting margins -- that is, the profitability standards selected by the Board -- drive the average rate increases.

6.117 Mr. Rae was critical of the Mercer Proposal, and particularly of Ms. Bass, because she interpreted section 20(4) of the Act in a strict, actuarial sense, or, as he put it "from a strict point of view of the industry" (see paragraph 6.103). The Board wishes to make it clear that the Board did not expect Mercer to interpret section 20(4) of the Act in any other way. The Board requested, and received, evidence with respect to the actuarially indicated rates. It is the duty of the Board to determine, in its sole discretion and on the whole of the evidence before it, what rates meet the standard of "just and reasonable and not excessive or inadequate". If expert witnesses were to substitute a personal view of the standard in the Act for their professional judgments, the Board and the

various publics affected by Board decisions would be badly served, because expert witnesses could advocate opinions outside their areas of expertise under the guise of professional judgments.

6.118 The Board agrees with the CAC and the NDP that the Board must consider the reasons for the level of industry-wide loss costs and industry-wide expenses. The Board is in a position to use the rate setting process to improve insurer efficiency and otherwise to advocate changes that will lower costs. In fact, issues of this nature were considered at length in Decision I-88-1C (Chapter 6) and will undoubtedly be the focus of much evidence in future hearings. In the Board's view, however, the rates must be related in some significant way to the insurance system that we have, as opposed to an optimum system in the eyes of the Board or any other body or person. In short, the Board will not do indirectly -- through rate setting-- what the legislature has not done directly, that is, modify the basic precepts of the insurance system in Ontario.

6.119 The Board is firmly of the view that it has jurisdiction to hear evidence relating to affordability. The Board heard such evidence in this

hearing. The Board will address below whether the issue of affordability can be determinative in rate setting. The Board is of the view that, whatever the answer to that question, general affordability can be considered in rate setting so that all of the implications of the costs of the insurance system can be aired and tested in some organized way through the public hearing process.

3. Statutory Standards

6.120 The Board adopts the general approach to the statutory standard outlined by Board Counsel and the CAC, and rejects that advanced by Mr. Howard. Put simply, the statutory standard requires that the Board balance the interests of those affected by automobile insurance rates, particularly consumers and insurers. In determining what is just and reasonable, the Board must also consider what is not excessive or inadequate. While the Board is attracted to the power inherent in the standard of "just" as outlined by Mr. Howard, the Board does not agree that it must apply the other statutory terms as an actuary would apply them.

6.121 The Board notes that Mr. Howard's formulation of the statutory standard can lead to perplexing results.

Under this approach, only those proposals that are actuarially based can meet the threshold requirement. The Board must essentially apply a test of credibility as to which actuarial proposal it prefers, even though the actuarial proposals may be very different in their results. While the Board understands Mr. Howard's caution that the Board should not substitute its own view for that of an actuary, the implications of this position are quite startling. If the Board followed this interpretation, it would not be exercising its discretion with respect to the evidence as a whole. The Board is obligated to decide the issues before it in its own opinion, and therefore the Board must be free to hear and weigh the evidence with respect to actuarial assumptions and determine the assumptions on which the rates will be based. The Board agrees that it cannot be arbitrary in determining the basis on which rates will be set, but it is of the view that it cannot be confined to accepting any actuarial proposal in its entirety, as opposed to using all of the actuarial evidence to reach a set of assumptions that, in the Board's opinion, result in rates that meet the statutory standard.

6.122 The Board does not determine in this hearing whether, as argued by the CAC, it is permitted to adopt a rate

that is not actuarially indicated. This issue will arise directly in a case where adequacy and affordability cannot be balanced to an acceptable extent.

6.123 In the Board's view, it would be folly to proceed on the basis that its jurisdiction is unfettered, or without limitation. That is not a good working hypothesis given the general judicial approach to the exercise of discretion by statutory tribunals. On the other hand, the Board does not think it necessary to define, at this time, the outer limits of its jurisdiction. In the Board's view, those limits may well move in and out according the circumstances before the Board at any particular time.

6.124 For instance, the concept of "adequacy" of rates received much consideration in this hearing. Board Counsel clearly was of the view that the Board could not set inadequate rates. The NDP and PC Party argued that affordability should prevail over adequacy. Although the Industry Coalition may not have contemplated that its approach to the statutory term "just" might be used to justify inadequate rates (Mr. Howard also argued that the Board has jurisdiction to

phase in rate increases), the limitations of this argument were not clearly delineated.

6.125 The evidence in Hearing I-88-1C and in this hearing indicate that the automobile insurance industry may not measure adequacy on an annual basis, but rather on a cyclical basis. Further, given the very early stage of regulation and the identified limitations of data, the standards of both "excessive" and "adequate" are very difficult to measure until such time as the market place stabilizes following the upcoming classification changes. Neither "excessive" nor "inadequate" has a definitive meaning that can be established in isolation from the existing circumstances within the industry.

6.126 The Board does not agree with the argument of the NDP that the Board can largely or entirely disregard profit with respect to automobile insurance, including the opportunity to earn. The NDP argued that the Act did not strictly provide for the opportunity to earn, but ignored the fact that the Act does not mention affordability either, even though the NDP and the PC Party consider affordability to be central to the statutory standard to be applied by the Board.

6.127 Mr. Rae referred to the profitability of the non-automobile lines of insurance business in Ontario in 1987. The Board assumes that he chose the comparison carefully. As shown in Schedule 9-B to Decision I-88-1C, aggregated company-wide ROE is 13.90 percent, as compared to 26.89 percent for all lines excluding automobile insurance. The Board can only extrapolate from Mr. Rae's argument that, in his view, if company-wide profitability is not excessive or inadequate, then automobile insurance profitability is irrelevant, whatever it might be.

6.128 If the Board were to adopt the methodology implied by Mr. Rae with respect to profitability standards, the Board would have to accept the principle that it is right and proper for other lines of insurance to subsidize automobile lines of insurance. This is not a simple matter, because consumers generally prefer not to cross-subsidize other lines of business on a basis that has nothing to do with the coverage they are purchasing.

6.129 The Board made clear, in Decision I-88-1C, that the methodology with respect to profitability standards would be thoroughly considered from year to year and the Board encourages any person to put a proposal for a

different methodology before the Board at the appropriate time. In adopting the methodology for 1989, the Board was cognizant of the fact that automobile lines represent only part of a company's performance. In any event, the Board is of the view that it must give companies an opportunity to earn, and that the underwriting margins adopted by the Board are appropriate for use in 1989.

6.130 The Board, in deciding how the overall rate level is to be calculated, will balance the interests of consumers and insurers to reach a just and reasonable result for the rates to be set for 1989. In determining whether the rates are excessive or inadequate, the Board will have regard to the principles outlined in paragraphs 6.90 and 6.91. In the Board's view, the rates or ranges of rates must give insurers an opportunity to earn the ROE selected by the Board. Further, the Board is aware of the difficulty of determining, in this first year, whether rates will be excessive. Accordingly, the Board will consider how to combine the benchmark rates and ranges to protect consumers.

4. The Actuarial Indication

6.131 The Board has considered carefully the actuarial

evidence concerning the overall rate level. The Board finds its rate making methodology, as set out in its Decision in Hearing I-88-1B, generally suitable for the task of industry-wide rate making for private passenger automobile. However, as indicated in that Decision, the methodology is not cast in stone and may be subject to review in some of its aspects in future years. The Board finds further that the methodology was applied appropriately by Mercer.

6.132 As the following discussion will indicate, the Board agrees with the majority of the judgments made by Mercer in relation to the data with which it was supplied. However, because of specific concerns about data quality, particularly in relation to the dramatic increase in 1987 accident year pure premiums and the volatility in the claim frequency data, the Board gives more credence than does Mercer to the possibility that the data may be anomalous. Accordingly, the Board has decided to make a number of modifications to the Mercer Proposal, as set out below.

(a) Unadjusted Pure Premium

6.133 It was established in both the written and oral evidence of Mercer that the 1987 accident year pure

premiums represented a substantial change over the 1986 accident year. Indeed, Mercer noted that there was significant volatility over much of the ten year history presented. Accordingly, rather than rely totally on 1987 data for rate making, as suggested by the Board methodology, Mercer included the 1986 accident year and assigned to it a 30 percent weighting, with 70 percent weight being assigned to 1987. The proposed weighting was based on that used traditionally by the IAO.

6.134 Evidence on behalf of the CAC given by Mr. Hunter suggested that, since the 1987 year is dramatically different from 1986, a more appropriate weighting would be 50/50 for the 1986 and 1987 accident years (Exhibit 22.1, at 13).

6.135 The Board, in considering all the evidence before it finds a weighting of 50 percent for each of the accident years 1986 and 1987 to be appropriate in the circumstances. The Board acknowledges that, ordinarily, greater weight should be given to the more recent year's experience. However, it is the Board's judgment that, in light of the challenges to the data, and Mercer's own reservations concerning the erratic nature of the annual changes in pure premium, claim

frequencies and severities, somewhat more credence should be given to the possibility that the 1987 data is anomalous.

(b) Loss Development

6.136 As outlined in paragraphs 6.17 and 6.18, Mercer followed the Board's methodology and applied to incurred losses a development factor derived from historical development patterns, notwithstanding concern about immature data and the underlying cause of the significant change in pure premium from 1986 to 1987. In so doing, Mercer assumed that 1987 would develop along the same patterns as established over prior years, and that the increase in pure premiums for 1987 did not represent either a strengthening of case reserves or a speed-up in the processing of claims. Mercer referred also to the years 1983 and 1984, which had exhibited a similar increase in pure premiums and had developed along historical development patterns.

6.137 Two alternative methods of calculating loss development, each of which would produce dramatically smaller development factors, were raised in evidence. The first, put forward by the CAC, used a form of paid loss development and is described in paragraphs 6.20-

6.21 above. The second, an IBNR adjustment, was undertaken by Mercer at the request of Board Counsel, as described in paragraphs 6.27 - 6.29. For reasons developed below, the Board rejects both alternatives to the Mercer loss development in favour of a modification of its own to the unadjusted pure premium to which the development factor is applied.

6.138 Mr. Hunter's reliance on paid claims rests upon his assumption that the 1987 incurred losses reflect case reserve strengthening. While the Board agrees that, in light of the factors suggested by Mr. Hunter, it is not unreasonable to conjecture that case reserve strengthening may have taken place, it does not believe that the evidence adduced at the hearing establishes that this has in fact occurred. This being the case, and because of the almost unanimous actuarial evidence concerning the potential for error inherent in relying on paid claims as the basis of development for long-tail lines, the Board does not accept Mr. Hunter's approach. In so deciding, the Board is not suggesting that reference to paid claims is inappropriate in all circumstances.

6.139 With respect to the IBNR adjustment undertaken by Mercer at Board Counsel's request, the Board has

decided that reliance should not be placed upon the aggregate of individual companies' IBNR as reported under the Board's FRP. The first reason for so concluding is that, unlike the method utilized by Mercer in accordance with the Board's rate making methodology, there is no actuarial support for such an approach. Equally important, in the judgment of the Board, is a concern that the IBNR reported figure may not be accurate. A number of reasons, including those suggested by Mr. Miller in evidence (Exhibit 11.6, at 3-5; Transcript, at 2636-46), and the abbreviated time frame within which companies had to complete the FRP, suggest that the aggregate reported number may be suspect, and may, indeed, be too low. Accordingly, the Board prefers to rely upon the loss data as the basis for calculating loss development.

6.140 The loss data for 1987 is, however, problematic. Of the three possible explanations for the dramatic increase in 1987 pure premiums over 1986 -- an actual increase in loss costs, case reserve strengthening, or an increase in the speed of claims processing -- the Board agrees with Mercer that the evidence does not clearly demonstrate either reserve strengthening or claims processing acceleration. Nevertheless, the

Board is concerned that the data may prove to be anomalous.

6.141 In order to mitigate the potential effects of anomalous data on the rate making process, the Board adopts a variation of the method outlined in the Mercer Proposal for third party liability, accident benefits, and family protection (Exhibit 5.1, at 12 - 13). The 1987 pure premium, which forms the basis of the rate making process, shall reflect a 50% - 50% weighting between (1) the actual 1987 pure premium, and (2) the pure premium that would have been projected for 1987 based on a least squares fit to an exponential curve of the prior nine years' pure premiums as of 12 months. This weighting gives 50 percent credence to the possibility that 1987 pure premiums as of 12 months are in fact the beginning of a trend towards increasing loss costs; and it gives 50 percent credence to the possibility that 1987 pure premiums are anomalous. It is a conservative assumption, which in the opinion of the Board is reasonable given the uncertainty of the data.

6.142 The Board's changes to the assumptions relating to relative weighting of 1986 and 1987 and the introduction of an estimated 1987 pure premium are consistent and relate to concerns about possibly

anomalous data. The latter change is to estimate the 1987 pure premium more accurately. The former, which is independent, recognizes a conservative approach to rate making in light of concerns about data quality, by averaging two years rather than relying on a weighting in favour of one year. These changes in assumptions will lessen any impact of anomalous data by reducing the influence of 1987 data on the rate level.

(c) Trend

6.143 The Board considers the trend algorithm used by Mercer a reasonable modification of the Board methodology, given the data in the present circumstances. The Mercer trend algorithm modifies the Board's trend methodology while retaining its essence. Further, the methodology has been applied by Mercer in a logical and consistent manner. Nevertheless, as outlined below, the Board considers that a number of adjustments should be made to the trend estimation.

6.144 Upon a review of the claim frequency data in relation to all coverages as a totality, the Board finds that there is no obvious and discernable trend over the long term, and accordingly has decided that the frequency component of trend should be accorded a weight of zero.

The Board notes that the IAO has made similar adjustments for data volatility reasons. This change also removes the "trend adjustments" made by Mercer because of claim frequency volatility to accident benefits (Exhibit 5.1, at 24) and comprehensive - \$25 deductible (Exhibit 5.1, at 31).

6.145 Severity trend is estimated as in the Mercer Proposal, but is revised to reflect the Board's changes to the 1987 unadjusted pure premium as of 12 months.

6.146 The decision of the Board to assign a value of zero to the frequency component of trend does not preclude reliance in the future upon frequency as an actuarially sound element of trend estimation. The Board expects that, in future periods, frequency trends may emerge that are more explicable.

6.147 The Board has decided to establish the rates as if they were to be effective from March 15, 1989 through December 31, 1989, rather than for a full year, as indicated in the instructions to Mercer. As outlined in Chapter 13, the Board intends to review rates again later this year, to be effective for 1990. This will permit the Board to better assess the development of current loss costs. This early review will be

particularly important should the 1987 pure premium, adjusted by the Board, develop differently. In recognition of this, the trend period has been modified to reflect an average accident date approximately 1.25 months shorter than the period contained in the Mercer Proposal. Further, after considering evidence with respect to the impact of six month policies on the trend period, the Board adopts the assumption, for this year, that 50 percent of private passenger automobile policies are 6 month policies and 50 percent are 12 month policies. Thus, a further shortening of the trend period is appropriate.

(d) ULE, Catastrophe, Variable Expense Provisions

6.148 The Board accepts the Mercer recommendations with respect to the unallocated loss expense provision, the catastrophe provision and the variable expense provision. These provisions conform, to the extent possible in light of data availability, to the methodology prescribed by the Board in its Decision in Hearing I-88-1B.

(e) Rate Group Drift

6.149 As will be discussed in Chapter 10 of this Decision,

the Board has decided to adopt the VCS proposal for the establishment of vehicle rate groups. For reasons set out by Ms. Bass in paragraph 6.45 above, the Board is satisfied that the VCS methodology does incorporate provision for rate group drift, and accordingly rejects the proposal by Mr. Hunter of the CAC that trend be eliminated for physical damage coverages.

6.150 Because rate group drift is so closely intertwined with the VCS methodology, the Board has experienced difficulty in determining whether the adjustment for rate group drift is appropriate. The Board is of the view that, in future years, VCS rate groups should not incorporate an adjustment for rate group drift. Rather, in accordance with the Board's Decision in Hearing I-88-1B, rate group drift should be considered as a separate item in the rate making methodology.

(f) Exposure Variable Costs

6.151 The Board has considered the Mercer estimation of the expense constant, as well as the adjustments to that estimation proposed by the CAC. The Board prefers the Mercer estimation to that advanced by the CAC, and adopts it except for the item relating to 1989 Board costs.

6.152 The Board has determined that the proposed rates should contain provision for the 1988 costs of the Board, rather than 1989 costs. The Board will adopt a practice of assessing its costs for payment in the year following that in which the costs are incurred. The result of this adjustment is an expense constant of \$42.

6.153 With respect to the proposed inclusion in the expense constant of a provision to cover the cost to companies of a one-time conversion to the Board's classification and rating systems, the Board acknowledges that such costs may well be substantial in some cases. The Board is concerned, however, that it could be very difficult to determine which of a company's costs are legitimately, and solely, related to conversion, and to establish an appropriate provision for such costs on a one-time industry-wide basis. Accordingly, the Board has concluded that companies should be required to accommodate conversion costs within the rate increases approved by the Board. If the rates and the upward range around these rates should prove insufficient, companies could apply to the Board for a deviation and establish their legitimate costs of conversion in the deviation proceedings.

(g) Conclusions Concerning Actuarial Indications

6.154 The effect of the abovementioned changes to the Mercer Proposal, taken together, is to reduce the proposed approximate rate level change of 35 percent to approximately 17 percent. The derivation of the underlying pure premiums for each coverage plus the expense constant resulting from the Board modifications to the rate methodologies is presented in Appendix E.

6.155 Mercer's evidence was that, to the extent premiums have not changed over time to reflect changing loss costs, its overall rate level recommendation reflects both a correction for prior rate inadequacy and the anticipated annual changes in loss costs projected to the prospective rating period. The Board calculates the annual loss cost trend after the abovementioned adjustments to be approximately 7.6 percent.

5. The Proposed Rate Level

6.156 During the course of the hearing, the Board was urged to have regard, in establishing rates or ranges of rates, not only to actuarial adequacy, but also to such considerations as affordability to consumers and the

encouragement of efficiency among insurers. Representatives of the New Democratic Party and the Progressive Conservative Party argued that the Board, in exercising its jurisdiction to set rates that are "just and reasonable and not excessive or inadequate", should put the interests of consumers first and not make the test simply one of actuarial adequacy. The CAC stated that the Board should consider the historical pricing practices of insurers and, like insurers, treat actuarial adequacy as only one factor in the rate setting decision. It recommended that the Board set benchmark rates below the actuarially indicated level to encourage insurer efficiency and to force insurers to strive for adequacy (Final Argument of the CAC, at 30-31).

6.157 Other parties and witnesses before the Board, including Mercer, insurers, the IBAO, and representatives of the Facility Association, stressed the importance of rate adequacy. While it may be that the industry can survive in the short term with some degree of inadequacy, the long-term effect of inadequacy is market constriction. Witnesses pointed to the experience under rate regulation in some American jurisdictions -- in particular, Massachusetts -- where

serious rate inadequacy coupled with an inability to deviate upwards have led to problems of availability and to a large increase in the population of the equivalent to the Facility Association (Bass, Transcript, at 885-86). Witnesses for the Facility Association testified that the single most important factor in controlling growth in the size of the Facility is rate adequacy in the voluntary market (McKay, Transcript, at 1429; Wieland, Transcript, at 1452).

6.158 Accordingly, while consumers of insurance have an obvious interest in obtaining coverage at the lowest possible price, and insurers in providing it at a level that covers their costs and provides a fair ROE, in the area of availability of insurance the interests of insurers and insureds converge. In a system of private automobile insurance, the rate must be adequate if market capacity is to be assured. At the same time, if the rate becomes so oppressive as to be unacceptable to the public, the private automobile insurance market is jeopardized.

6.159 The Board appreciates the serious difficulties faced by many insurers today. Companies' rates were frozen on April 23, 1987, at a time when many companies, for a

number of reasons, were operating at inadequate rate levels and were attempting to move towards rate adequacy. Since that time, companies have been permitted a cumulative rate increase of 9.2%, but have been faced with increases in loss costs in excess of that amount. Some insurers are more poorly positioned than others, having been caught by the freeze before they had a chance to increase rates. The Board does not suggest that company pricing decisions have always been well considered or well advised. Companies have made tactical business choices that have contributed to the overall circumstances in which the industry and consumers find themselves today. Nevertheless, the Board must take into account the actual situation of the industry and work forward from that point.

6.160 The Board is deeply concerned as well about the impact of very large increases upon consumers at a time when some are facing a considerable premium rise as a result of the simultaneous introduction of a new classification plan. Quite apart from the overall rate increase under discussion, the majority of insureds will experience some upward adjustment in premiums, as a result of the legislatively mandated elimination of age, sex, and marital status as rating variables. The impact upon some segments of the population -- in

particular, young females and newly-licensed older drivers -- will be very significant.

6.161 It is the task of this Board, in setting rates, to balance the interests involved, and in so doing the Board is mindful of its jurisdiction under section 20(7) of the Act to consider "any financial or other matter directly or indirectly affecting rates".

6.162 It is the opinion of the Board that the prevailing circumstances must always inform the rate setting decision. The circumstances of the present time -- the simultaneous lifting of the government rate freeze and the implementation of a new classification plan involving substantial dislocation -- require that the Board fix its benchmark rates at other than the actuarially indicated level.

6.163 The Board has determined that the benchmark rates for the period March 15, 1989 to December 31, 1989 should be set with reference to the annual loss cost trend, as determined in accordance with the Mercer methodology as adjusted by the Board in this Decision - that is, at approximately 7.6% above the current average rate level. This would permit insurers to cover the costs projected for the rating period.

- 6.164 In its Decision in Hearing I-88-1B, the Board decided that it would ordinarily set ranges of rates, rather than single rates. The size and application of the ranges adopted by the Board in this Decision, as well as the reasons underlying the decisions of the Board in this respect, are dealt with in some detail in Chapter 9. At this juncture, however, it will be convenient to discuss briefly the proposed limit of the upper range established by the Board, in order to put the decision concerning the benchmark rates in context.
- 6.165 In order to permit insurers an opportunity to achieve rate adequacy, the Board has decided to set the upper range at the actuarially indicated level -- that is, at the level represented by the pure premiums as set forth in Appendix E. For all coverages combined, these pure premiums, when adjusted to provide for expenses and the underwriting margin, produce final premiums that are approximately 17% above the average current rate level. The Board recognizes that the true rate level increase may differ somewhat from insurer to insurer since today auto insurance rates are greatly dispersed.
- 6.166 By establishing the upper bound of the range at the premiums resulting from the actuarially indicated pure

premiums and by establishing the Board benchmark rates at a premium level that approximates a 7.6% increase, the Board implicitly establishes the size of the upper bound of the range to be 9 percent. The actuarially indicated pure premiums represent very different changes by coverage, and to preserve this relationship, the Board benchmark rates are determined by dividing each of the actuarially indicated pure premiums by 1.09 to produce the benchmark rates.

6.167 This decision represents, in the view of the Board, the most reasonable balance between the interests of insurers and those of insureds in light of the prevailing circumstances. It attempts to minimize the double impact upon consumers of a general rate increase and an increase consequent upon implementation of the new classification plan, while permitting insurers to achieve, or to make progress towards, rate adequacy by utilizing the range above the benchmark rates. At the same time, it does not encourage those companies that are not now in a position of inadequacy to implement large increases.

6.168 The Board notes that, in setting its benchmark rates below the actuarially indicated level, it is not adopting Mr. Hunter's "market competitive model" or

"fully competitive model". While the Board sees obvious merit in encouraging efficiency, it believes that, in the absence of criteria to measure efficiency, any adjustment of the sort proposed by Mr. Hunter would be arbitrary at this time. The Board notes that the very use of industry average expenses denies recovery to those whose expenses exceed the average, and, to that extent, encourages some measure of efficiency. The Board also believes that further adjustment to the Mercer expense estimation would be inappropriate at this time, because of the additional expense that will be incurred by insurers in converting to the Board Class Plan and rating systems, for which the rate making formula contains no express provision.

6.169 The Board's decision to set its benchmark rates below the actuarially indicated level represents a policy choice in favour of mitigating the effects upon consumers of the imposition of two sets of rate increases at one time. The Board recognizes, however, the similarity in the results of its approach and that advocated by Mr. Hunter. To the extent that the upper bound of the range of rates -- the actuarially indicated rate level -- reflects the efficiency level of the "average" auto insurer, the concerns of the CAC

that insurer efficiency be reflected in the Decision of the Board may be seen to be addressed.

6.170 The Board acknowledges that the rates and upward range established by this Decision may be insufficient for some companies to achieve actuarial adequacy in 1989. Depending upon such factors as the extent of a company's inadequacy at the time of the freeze, and differences in the book of business among companies that may require utilization of the range for other purposes, many insurers will not earn an ROE of 12.5% in 1989. Moreover, to the extent that the rates and range established by the Board in this Decision may be insufficient to permit adequacy to be achieved on an industry-wide basis, the next rate proposal to be considered by the Board will likely reflect that fact.

6.171 The position in which such companies find themselves is not, however, without precedent. As indicated by the evidence of witnesses for the companies that appeared before the Board, insurers have on occasion in the past decided to endure some degree of temporary rate inadequacy because of competition and the impact of the indicated rate increases upon their insureds. The Board notes, also, the availability of deviations, and the fact that, in the autumn of 1989, the Board will

establish new rates, to be effective January 1, 1990. At that time, the effects of the new classification plan will have worked themselves, at least partially, through the system, and the Board will consider the need of the industry for a rate level change in light of the 1988 loss data and the circumstances prevailing at the time. It must be recalled that profitability in the Ontario automobile insurance industry, and in the property and casualty insurance market place in general, has not traditionally been considered solely from an annual perspective. There is a profitability cycle, and the relationship between rate adequacy, profit and pricing decisions has been very dynamic. The Board does not wish to maintain the detrimental aspects of this cycle. Nonetheless, this dynamic will continue and the new market place must emerge and be studied over time.

C. TRANSITIONAL RATES

6.172 An issue considered in this hearing was the feasibility and desirability of lessening the impact of rate increases upon consumers by means of an order for transitional rates - that is, (1) an order that the rates established by the Board be phased in over a period of time, or (2) an order that the amount by

which any individual's premium might increase or decrease be subject to a cap.

1. Phase-In

6.173 The concept of a phasing-in of rates assumes that the rate increase set by the Board is too large for consumers as a group to bear at one time. A phase-in would result in part of the increase being imposed now and the rest at some future time or times. It is used to soften, in the short run, the impact of a large increase.

6.174 Generally, those witnesses who found a phase-in acceptable did so on the grounds that it was a common business practice to phase in large rate increases (Pafco, Final Argument, at 5; Dominion, Transcript, at 3956). As stated by Mr. Belton of Pafco (Transcript, at 3990):

... it seems evident to us that for reasons of consumer acceptance and competitive pressure a rate increase of the magnitude indicated by Mercer would be phased in if this were an unregulated market. Therefore, we believe it to be acceptable.

6.175 It was suggested that any Board phase-in of rates should be accompanied by "a clear message" informing

the consumer: (1) that the increase was an interim increase (the first of a number) in a progression toward the actual rate requirement of the industry; (2) that the balance of the actual rate requirement would be phased in, in addition to an increase reflecting the ongoing needs of the industry; and (3) of the steps being taken to reduce, or at the very least limit, the growth in loss costs in order to keep future rate increases to a minimum (Final Argument of Safeco, at 15).

6.176 Further, it was submitted that, once the actual rate requirement was recognized, the phased-in increase could not be unreasonably low and the actual rate requirement should be phased in "in the shortest possible time" (Industry Coalition, Written Submission, at 19; and see State Farm Argument, at 7). Safeco submitted that the actual rate requirement level should be reached by January 1, 1990 (Final Argument, at 16). Royal suggested that adequacy would need to be reached within "a reasonable time frame ... [p]erhaps eighteen months" (Elms, Transcript, at 1885).

6.177 Submissions against a phase-in were based on the principle that it is the Board's responsibility, pursuant to the Act, to set rates that are just and

reasonable and not excessive or inadequate (Economical Mutual, Exhibit 3.432, at 8). "That rate ["based on the best evidence"] should not be phased into use" (Gore Mutual, Exhibit 3.433, at 4).

6.178 It was also submitted that it was unnecessary for the Board to provide for a phase-in, as the companies would use the ranges set by the Board to accomplish the same purpose. As stated by Gore Mutual (Exhibit 3.433, at 4):

The 'phase-in' responsibility to the new rating level is best left to the companies, and, to the brokers or agents who distribute the product. Current rate levels (pre June 1, 1989), current experience, policyholder relations, etc. are variables among companies and will influence individual company selection of actual rate level relative to O.A.I.B. benchmark. Strategies for proceeding to indicated and permitted levels will constitute one of the elements of competition in the new system. (See, also, Economical Mutual, Exhibit 3.432, at 8).

6.179 With respect to the effect of phasing in increases, so that, for instance, half would be implemented immediately and half six months from now, Ms. Bass commented as follows (Transcript, at 3357-58):

Well, that is fine if you are writing six-month policies, but if you are writing annual policies - and a lot of insurance companies should write annual policies - you are not

phasing it in for the people whose policies come up for renewal in that second half because they will get both of those rate changes at once.

So that is not a phase-in for anybody, it doesn't break the blow for them significantly.

In oral argument, Mr. Howard also recognized that phasing in rates may not be "just" for all consumers; persons with early renewals may be advantaged by having lower rates for a longer period of time (Transcript, at 3879). The Board notes that, when the policies of these insureds are finally renewed, they will receive no benefit from the phase-in.

6.180 The parties supporting the Board's jurisdiction to implement a phase-in of rates did not address the issue of jurisdiction at any length in written argument. State Farm stated (Argument, at 9):

We find no section of the Act which precludes the Board from setting transitional rates....

The position of the Industry Coalition was as follows (Written Submission, at 18, 25):

... The only basis by which the Board could phase in a rate increase is if it determined that a one time increase was not just.

....

The Industry ... does not propose to make specific submissions to the Board as to whether implementation of the Mercer proposal is to be made in one policy period. This determination must be left to the discretion of the Board weighing the interests of both the insurers and the consumers.

6.181 Counsel for State Farm, Mr. Brown, when questioned by the Board during argument, recommended a range of rates increased on the downward side if phased-in rates were not permitted (Transcript, at 3947).

6.182 The submissions against the Board's jurisdiction to phase in a rate increase were made by Gore Mutual and Economical Mutual (both cited above) and Board Counsel (Submission, at 14/16-14/17; Transcript, at 3851-53). The essence of these submissions was that the Board's mandate to set rates that are just and reasonable and not excessive or inadequate conflicted with the concept of a phase-in. To phase in an increase over time would mean that the first rate order issued by the Board would provide for inadequate rates on an industry-wide basis. As submitted by Board Counsel (Submission, at 14/16-14/17):

The rates by definition could therefore not fit within the Board's mandate ... and are therefore beyond its jurisdiction.

Board Decision

6.183 The assumption behind phased-in rates, as stated previously, is that the average rate increase is very large and a phase-in is necessary to soften the impact of such an increase. The Board does not consider that the rates established by this Decision result in an average increase of such a magnitude as to fit that assumption. It is therefore the opinion of the Board that there is no need for the Board to consider an order phasing in the rates set pursuant to this Decision.

6.184 The Board makes no finding as to its jurisdiction to order that an increase be phased in. However, it does note that a phase-in could result in a practical problem that was not addressed by the proponents of phasing. After a rate order is issued, each insurer is to file the rates it intends to charge for the classes of risk exposure prescribed (section 22). Accordingly, insurers would be obligated to file their rates after each rate order phasing in an increase. Further, those insurers that had been granted a deviation under a previous rate order would have to accept the new rates or apply once again for a deviation and be subject to a hearing. The potential administrative

problems, both for the industry and the Board, as well as the expense involved and the resulting confusion among consumers, are matters that the Board would have to consider carefully before ordering a phase-in, even assuming that jurisdiction existed to make such an order.

2. Capping of Rate Changes for Individual Insureds

6.185 The concept of capping individual rates assumes, in the context of this hearing, that there is a need to soften the combined impact of a general rate increase and the dislocation caused by the new classification plan, which eliminates age, sex, marital status, family status and handicap as rating criteria on the ground that these are prohibited under section 33 of the Act. Under this concept, an individual's premium would not increase or decrease beyond a certain percentage. For example, if A were currently paying \$50, and the new rate for this risk based on the Board Class Plan were \$75, then, assuming a cap of 20%, A would pay \$60. As stated in the Submission of Board Counsel (at 14/17):

The reasons for capping would be to prevent rate shock ... and to avoid extreme volatility for any individual consumer.

6.186 The CAC witness, Mr. Hunter, favoured capping, stating as follows (Transcript, at 2894):

... no individual should have a change up or down by more than one third in their rate, exclusive of risk change. ... [T]here ought to be some kind of a transitional way to ease the blow for someone who is on the way up.

Mr. Hunter's proposal was limited to "renewal transitions" (Transcript, at 3472).

6.187 The Facility, while adopting the Written Submission of the Industry Coalition on this matter, recommended that rates for principal drivers with less than one year experience be capped at a differential of 1.5 of the industry benchmark rates during a transitional period. This class should be allowed "to find its own level" over a three year period when statistics will be available to support a contrary differential. The Facility submitted that it is possible to cap individual rates in the Facility (Submissions on Behalf of Facility Association, at 26-27).

6.188 A number of difficulties with the use of capping as a transitional measure to lessen the impact of large rate increases were raised in evidence. Among the difficulties raised were questions of practicality.

It was agreed that, in assessing a maximum rate change, it would be necessary to exclude from the calculation of the amount to be subjected to the cap any increase consequent upon a change in the degree of risk (Bass, Transcript, at 594-95; Hunter, Transcript, at 2989).

- 6.189 The Industry Coalition pointed out that capping would require companies to maintain two rating systems (the company's current system and the Board Class Plan), and that it would be "prohibitively expensive and overly complicated, assuming it could be administered at all" (Written Submission, at 19-20). Gore Mutual stated (Exhibit 3.433, at 4):

Individual capping is a programming nightmare and it would be difficult to monitor that the policyholder remains within tolerance levels relative to benchmark and deviation band. It would also create anomalies when comparing the premium of two policyholders in the same new classification cell.

- 6.190 The testimony of State Farm illustrated another problem with capping, where an insurer's current classification system is very different from the Board Class Plan (Lehmann, Transcript, at 2303). If the current rate for a risk were \$100 and the new rate were \$160 (assuming a downward range of -20%) with a cap of 25%,

then the company rate would be \$125, which would not be within the Board-set range.

6.191 Ms. Bass indicated that capping would present a practical problem from the perspective of uniformity. For example, since companies are not currently at the same rate level, if the maximum rate change were 10%, one risk currently paying \$300 would pay \$30 more, while another, currently paying \$400, would pay \$40 more (Transcript, at 751-52, 835).

6.192 It was further suggested that capping could result in a greater movement of drivers with capped rates to the Facility Association (Pilot, Transcript, at 2618; Final Argument of Safeco, at 17). Pafco argued that capping would cause "distortions in the marketplace and [force] a group of policyholders to subsidize another" (Pafco, Final Argument, at 6).

6.193 A number of the parties, including the CAC, pointed to legal difficulties in the concept of capping. The Industry Coalition pointed out that capping would require companies to keep the old rating system in place, and submitted that "any imposition of a maximum transitional rate that requires the old rating system

to be kept in place, violates Section 33 of the Act" (Written Submission, at 26). Capping would result in a continued differentiation on the basis of sex, females with capped rates paying less than males. Assume, for example, that A (a female) currently pays \$50 and B (a male) pays \$100, and that the new rate for these identical risks is \$75; with a 20% cap, A would pay \$60 and B would pay \$80. In cross-examination by Counsel for the Industry Coalition, Mr. Hunter stated that, in making his proposal for a one-third maximum transitional rate change, he had been unaware that such discrimination was prohibited by law even during the transitional period (Transcript, at 3470).

6.194 Board Counsel submitted that capping would deny the industry the opportunity to earn a fair return, and would breach the Board's mandate to set just and reasonable rates (Transcript, at 3825, 3851-53). Board Counsel also submitted that the Board sets rates in the aggregate ("industry-wide rates in an industry-wide hearing") and not on an individual basis (Transcript, at 3851-52; Submission, at 14/17).

6.195 Safeco submitted that the adoption of the Mercer ranges and of Mercer Option 3 dealing with the application of the ranges (discussed in greater detail in Chapter 9)

would assist consumers adversely affected by the new classification scheme (Transcript, at 3974):

With the competitive features made possible by these options, the individual driver could minimize her or his rate increase by shopping for the most competitive rate given that the company is financially strong and providing good claims policy service.

6.196 Certain companies also expressed the view that increasing the range downward would permit companies to lessen the effects of dislocation upon consumers (Allstate, Transcript, at 2093; Co-operators, Transcript, at 2220; State Farm, Transcript, at 2304).

6.197 The CAC, recognizing the legal and practical difficulties inherent in capping, submitted that lowering the differentials for inexperienced drivers and making the classification differentials additive would soften the impact of a large increase and a change in the classification system (Final Argument of the CAC, at 28).

Board Decision

6.198 The Board has determined that there will be no capping of individual rates. The Board is satisfied that capping would perpetuate a classification system that

contravenes the Act. The Board's decision is also influenced by the "administrative nightmare" that would be created by such a system.

7. CLASSIFICATION DIFFERENTIALS

A. INTRODUCTION

7.1 Once the province-wide pure premium for each coverage is calculated, it must be distributed among the individual classification cells. This distribution is usually effected by comparing the relative claim experience of insureds in the classification cell to the experience of insureds province-wide. The result of this comparison is a classification relativity or differential.

7.2 The process of establishing and combining classification differentials has no effect on the indicated overall premium level. Rather, it is a means of allocating that premium among persons possessing different risk characteristics. To this extent, the process has been termed a "zero sum analysis". It is clear, however, that the establishment of differentials that accurately reflect the risk potential of individuals is of vital importance to those concerned.

B. DATA

7.3 Because the Superintendent's Statistical Plan does not

correspond to the classification plan established by the Board in Hearing I-88-1A, Ontario insurance claim and exposure data is not generally available for many of the classification cells contained in the Board Class Plan. Accordingly, in establishing differentials, Mercer was forced to rely on (Exhibit 5.1, at 37-38):

- (1) IBC and IAO classification data, to the extent Mercer considered it useful;
- (2) current rating practices of Ontario insurers; and
- (3) collateral information from other jurisdictions relevant to the Board Class Plan.

7.4 The data supplied by the IBC and IAO and utilized by Mercer is set out in Exhibit 5.1, at 38. Mercer relied on the IBC/IAO data without independent audit. Mercer makes reference (Exhibit 5.1, at 39) to certain reversals and anomalies, some of which were overcome by regrouping or excluding some data. Other data problems could not be overcome, with the result that Mercer relied on the data with caution, or turned to collateral sources, such as Ontario insurers' rate manuals and data from other jurisdictions, to either validate or replace the IBC/IAO data.

7.5

As outlined in more detail in Chapter 5, the reliability of the IBC/IAO data available to Mercer for purposes of classification rate making was open to serious question. Because of data availability and reliability problems, Mercer was forced to make a significant number of judgments, and with some of these judgments the CAC, among others, took issue. In particular, the CAC objected to Mercer's reliance, in many cases where data was unavailable or unreliable, on current industry practice. Because of data concerns and Mercer's reliance on industry practice, the CAC urged the Board to look carefully at the proposed differentials. It referred to Mr. Hunter's advice that, if the Board is to err, it is better to charge 100 persons \$10 too much so that one person could pay \$1,000 less, than to charge one person \$1,000 too much so that 100 persons could pay \$10 less (Final Argument of the CAC, at 10-11).

7.6

The following is a summary of Mercer's treatment of the differentials for the classification cells contained in the Board Class Plan, and of the objections raised in evidence to that treatment.

C. CLASSIFICATION DIFFERENTIALS

1. Territory

7.7 Reflecting Ontario industry practice, Mercer treated territories independently from other classification variables for purposes of rating (Exhibit 5.1, at 40).

7.8 Mercer's process of estimating territorial differentials is set out in Exhibit 5.1, at 44-46, and in Exhibits 59-61 thereto. Essentially, the Mercer estimation was based upon the results of IBC and IAO data, as well as information concerning the current market practices of large Ontario insurers with respect to territorial relativities. Subject to a maximum change of five points from the ten insurer average, Mercer weighted the IBC, IAO and insurer data 40/20/40, to reflect differences in the reliability and relevance of the data. Mercer was unable to obtain claims data separately for the five Metropolitan Toronto territories under the Board Class Plan, and accordingly recommended the same differential for each territory.

7.9 The Board heard little evidence concerning the Mercer Proposal for territorial differentials, apart from some

indication that certain insurers are not accepting new clients in Metropolitan Toronto because of bad loss experience (Evidence of Co-operators, Transcript, at 2097-2102), and a number of complaints from members of the public residing in certain metropolitan areas and border communities, to the effect that their rates were too high. The CAC also suggested that the Board consider consolidating some territories because of data unavailability (Final Argument of the CAC, at 11-12).

2. Vehicle Use and Annual Driving Distance

7.10 Reflecting current industry practice, Mercer treated as dependent variables the two Board Class Plan classification variables of vehicle use (pleasure, commute, business and farm) and annual driving distance (short, medium and long) (Exhibit 5.1, at 40).

7.11 The derivation of the differentials for these variables is outlined in Exhibit 5.1, at 46-48 and Exhibits 63-66 thereto, and is summarized as follows in the Submission of Board Counsel (at 2/21):

2.50 Exposures by vehicle use were obtained by the IBC separately for third party liability and collision, and further refined into urban and rural territories. Exposures by annual driving distance were based on a

1981 study by IBC, since this variable is not now captured in the statistical plans of either the IBC or the IAO (Exhibit 5.1, p. 47).

2.51 Mercer calculated, for each vehicle use class, the credibility-weighted pure premium relativities to a 'base class' pure premium by coverage and by urban-rural territory group. Pleasure use was the base class for this exercise. Vehicle use target differentials were then selected.

2.52 Driving distance data is not available through the IBC or IAO statistical plans, so the distance differentials in use in the Ontario market place became the foundation for these differentials (Exhibit 5.1, p. 48).

7.12 The proposed differentials were the subject of very little evidence or cross-examination. The CAC recommended in final argument that the Board "consider increasing the differentials for medium and long term business use, particularly for third party liability" (Final Argument of the CAC, at 12).

3. Years Licensed, Principal and Secondary Drivers (Including Driver Training)

7.13 Number of years licensed is a new rating variable introduced by the Board Class Plan; it is not generally treated today as a separate variable, but is one of a number of factors determining the driver record. Mercer was unable to find any Ontario industry precedent for use of number of years licensed without

reference to age, sex and marital status. Accordingly, Mercer turned to Massachusetts, which, having eliminated age, sex and marital status, relies on number of years licensed of the principal and secondary drivers as the basis of its classification system. Massachusetts treats principal and secondary driver experience as dependent variables, and Mercer recommended the same treatment for Ontario (Exhibit 5.1, at 41).

7.14 In estimating differentials, Mercer looked first to the IBC, which since 1985 has captured data by number of years licensed for the principal driver and the least experienced secondary driver. At the request of Mercer, the IBC subjected the 1986 and 1987 accident year data to a minimum bias model on a multiplicative pure premium basis. While the results were unstable, the data suggested that higher rate differentials are appropriate for less experienced principal drivers. Differentials for drivers with less than 2 years experience ranged between 2.5 and 3.5 times the pure premiums for drivers with 6 or more years experience. The results for secondary drivers were similar, although less definitive.

- 7.15 Mercer looked also to industry practice and arrived at a rough approximation of rating differentials based on assumptions concerning the age at which individuals become licensed. The results of this analysis indicated differentials for newly licensed drivers without driver training of about 4.5 times the rates for experienced drivers in the most favourable driver classification, and 3.5 times those rates for newly licensed drivers with driver training.
- 7.16 Mercer also referred to Massachusetts, which charges the least experienced driver an average rate that is approximately twice that charged to the most experienced driver.
- 7.17 In light of the IBC indications, Ontario industry practice, and the Massachusetts relativities, Mercer proposed a series of relativities set out in Exhibit 67 to Exhibit 5.1. The proposed relativities range downwards from a maximum of 3.5 for a newly licensed driver without driving training (regardless of whether there is a secondary driver), and 2.8 for a similar risk with driver training. The driver training discount is based upon Ontario practice.

7.18 The differentials for both principal and secondary inexperienced drivers were opposed by the CAC as excessive (Final Argument of the CAC, at 13-14). The CAC noted the limited utility of the Ontario data underlying the estimation, as well as the lower Massachusetts differentials. It also referenced two case studies (Cases 4 and 35) appended to the Mercer Proposal, stating that it is anomalous that an inexperienced driver with no convictions or claims should pay more than an experienced driver with claims and convictions. The CAC recommended that the maximum differential be set at 2.00, and that the remaining differentials be scaled down accordingly.

7.19 Mercer pointed out (Exhibit 5.1, at 48) that the Board Class Plan does not deal with the method of determining the driving experience of the secondary driver where more than one secondary driver is assigned to a vehicle. Mercer assumed that the driving experience of the least experienced secondary operator would govern in such a case. Mercer further recommended (at 51) that the Board adopt a rating rule similar to one in force in Massachusetts, which reads:

If the combined operation of the insured car by inexperienced operators is more than experienced operators, the applicable

inexperienced operator classification shall apply.

7.20 In its Partial Decision with Reasons, dealing with Board Class Plan changes, dated January 20, 1989, the Board rejected the Massachusetts rule and adopted explicitly a rating rule that provides that the least experienced driver (defined in terms of years licensed) will be the applicable classification for the secondary driver (at 11-12).

4. Vehicle Rate Group

7.21 The Board Class Plan contains a classification and rating variable based on vehicle characteristics. The quantification of the rate group relativities was done as part of the VCS proposal and is considered in Chapter 10. Mercer incorporated the relativities recommended by the VCS without comment or endorsement (Exhibit 5.1, at 59).

5. Abstinence

7.22 Mercer recommended that abstinence be treated as an independent variable (Exhibit 5.1, at 43). Because of a lack of data dealing with the loss experience of abstainers, Mercer recommended a conservative discount

of 5 percent. This is below the discount offered by the two Ontario insurers that use abstinence as a classification variable at present (Exhibit 5.1, at 59).

7.23 The proposed differential generated little controversy, although Counsel for State Farm suggested that, in the absence of data, the differential should perhaps be set at zero (Transcript, at 583); and the CAC recommended that the Board monitor the number of insureds qualifying for the discount (Final Argument of the CAC, at 15).

6. Number of Vehicles in the Household

7.24 The IAO provided Mercer with some aggregate Ontario data on the number of vehicles per household. However, while cars coded with a multi-vehicle discount are reported to the IAO, the data may not be truly reflective of the experience of multi-vehicle households, because of differences in application of the discount by insurers. Nevertheless, the IAO experience suggests that a multi-vehicle discount is appropriate.

7.25 Mercer noted that most Ontario insurers offer multi-vehicle discounts of between 10 and 15 percent, but apply such discounts differently. For example, in the case of a household with two vehicles insured by the same insurer, some insurers apply the discount to both cars, while others apply it to the second car only. In light of varying industry practice, Mercer selected a 10 percent discount, to apply to each vehicle in the household (Exhibit 5.1, at 60). It recommended further that the variable be treated as independent (Exhibit 5.1, at 43).

7.26 The recommended differential was not the subject of controversy.

7. Convictions and Number of Claims/Number of Claim-Free Years

(a) Manner of Estimation and Combination

(1) Convictions

7.27 The evidence of Mercer (Exhibit 5.1, at 41) stated that the general insurance practice in Ontario is to treat conviction surcharges independently of other classification variables. Mercer noted that, despite

the existence of some evidence indicating that claims and convictions interact as predictors of risk, they had no information or prototype model available to link the two logically. Mercer therefore recommended that industry practice be followed until an analysis of data collected under the Board Class Plan could be performed.

7.28 Because conviction history is not currently coded by either the IBC or the IAO, Mercer relied on current industry practice and on information external to Ontario to establish conviction surcharges (Exhibit 5.1, at 52). Mercer departed from current industry practice, however, by recommending that the surcharges be additive, rather than multiplicative.

7.29 In proposing additive rather than multiplicative surcharges, Mercer was concerned to avoid the possibility of "double counting" - a possibility that exists where the increased risk cannot be quantified for every classification variable. The potential for double counting is greatly increased if a multiplicative rather than an additive surcharge is used. This is because any errors made in risk calculations are multiplied using a multiplicative method (Exhibit 5.1, at 53-54; Bass, Transcript, at

193-96). Noting that the differential for inexperienced drivers already contemplates a much higher than average accident frequency, Mercer expressed the view that "to compound this with a conviction surcharge on a straight multiplicative basis may be too extreme" (Exhibit 5.1, at 54).

7.30 The Mercer criteria for selecting conviction surcharges were as follows (Exhibit 5.1, at 54):

- (1) Convictions surcharges are dollar amounts, rather than a percentage surcharge;
- (2) Surcharges for serious, major and minor convictions decrease with the seriousness of the offense;
- (3) Surcharges are strictly cumulative--the more convictions, the higher the surcharge;
- (4) Dollar surcharges should, on an average percentage basis, approximate the charges used by the industry today;
- (5) On an aggregate basis, the sum of the dollar surcharges should be approximately equal to the sum of the percentage charges.

7.31 Mercer used a two step process to arrive at the recommended surcharges. First, Mercer considered what the relevant percentage surcharges should be based on industry practice. These were determined to be: 50% for each serious chargeable conviction; 15% for each

major chargeable conviction; and 10% for each minor chargeable conviction. Mercer then converted the percentage surcharges to average dollar amounts by applying the percentages to the average province-wide pure premium including variable costs (Exhibit 5.1, at 54-55). The applicable surcharges are set out in Exhibit 68 to Exhibit 5.1.

7.32 The Supplemental Decision of the Board in Hearing I-88-1A provided for a forgiveness of two minor convictions in a two year period, unless a major or serious conviction has occurred in the same period. Mercer indicated that the forgiveness period should be changed to three years in order to keep it consistent with the conviction history period and to avoid administrative difficulties in dealing with two separate time periods (Exhibit 5.1, at 52). This matter was dealt with by the Board in its Partial Decision I-88-1D, dated January 20, 1989. The Board provides (at 4) for a forgiveness of two minor convictions in a three year period unless a major or serious conviction has occurred in the same period.

(2) Number of Claims/Number of Claim-Free Years

7.33 It is current Ontario industry practice to treat the

number of claims and number of claim-free years as independent rating variables. Both industry practice and the Board Class Plan consider number of claim-free years within the context of a 6 year history. Current industry practice charges claims over a three year period, while the Board Class Plan envisages a six year surcharge period (Exhibit 5.1, at 42).

- 7.34 Because Mercer considered the two variables to be logically dependent, it departed from Ontario practice and combined number of claims and number of claim-free years into a single "claim history" classification, which incorporated elements of a "bonus/malus" system (Exhibit 5.1, at 42).
- 7.35 Since claims are defined differently under the Board Class Plan than under the Superintendent's Statistical Plan, Mercer was unable to rely on insurance industry data to estimate claim surcharges. Moreover, coding errors in IBC data precluded Mercer from using IBC data, even as a validation of its ultimate selections.
- 7.36 Nevertheless, Mercer's research indicated that virtually all insurers use number of claim-free years and number of claims in their classification and rating plans. Although Mercer was aware of several studies

from other jurisdictions linking claim history to the probability of future claims, the studies did not provide enough information to quantify the surcharges (Exhibit 5.1, at 55-56). However, a review of the studies and of current insurer manuals indicated that a relatively high surcharge for claims was appropriate (Exhibit 5.1, at 58). Based on this information, Mercer proposed claim history rate differentials or surcharges that would meet the following criteria (Exhibit 5.1, at 58):

- (1) The differentials should increase with an increasing number of claims;
- (2) The differentials should decrease with an increasing number of claim-free years;
- (3) The differential for additional claims should approximate current industry practices, tempered to reflect the uncertainty surrounding the impact of the new classification plan;
- (4) Dollar amounts should form the basis of the claim surcharge rather than percentages, similar to the manner in which convictions are surcharged.

7.37 The proposed claim history surcharges were developed in a manner similar to that used for conviction history surcharges. Mercer first developed a table of rate differential factors and then converted them to dollar amounts by applying the percentages to average

premiums for each coverage. The claim history surcharges recommended by Mercer are set out in Exhibits 69-71 to Exhibit 5.1.

7.38 As in the case of conviction history surcharges, Mercer proposed that claim history surcharges be additive (Exhibit 5.1, at 58-59).

(b) Evidence of the Industry

7.39 Certain industry parties voiced support for a multiplicative, as opposed to additive, treatment of surcharges. State Farm argued that surcharges for claims and convictions should be multiplicative in order to avoid the subsidization of bad drivers by good (State Farm Argument, at 2). Kingsway also supported a multiplicative treatment of surcharges (Star, Transcript, at 2761).

7.40 While the Facility Association did not object to the additive treatment of surcharges (McKay, Transcript, at 1422-24), it was concerned that the Mercer surcharges would produce insufficient revenue, certainly for the Facility Association, and perhaps also for the voluntary market. The result, in the view of the

Facility Association, would be that good drivers would subsidize bad drivers.

7.41 The evidence of the Facility Association indicated that the surcharges currently used by the Facility are significantly higher than those proposed by Mercer (Exhibits 9.9, 9.12), and that, even with higher surcharges, non-surcharged Facility business is subsidizing surcharged Facility business. It was pointed out that application of the Mercer surcharges to Facility risks would produce a reduction in surcharge premiums of 38.5%, or in total premiums of 4.2%, for the year 1987 (Exhibit 9.12, at 1).

7.42 Witnesses for the Facility suggested that, while insurers in the voluntary market may have manual rates for drivers with claims and convictions, many may not in fact write such business and that, accordingly, it may be appropriate to look to the surcharging practices of those who actually insure such risks, the non-standard insurers and the Facility Association (McKay, Transcript, at 1423-24, 1563-64; Wieland, Transcript, at 1502-04).

7.43 Witnesses for non-standard insurers took the position that the claims and convictions surcharges proposed by

Mercer were too low, at least for non-standard insurers and the Facility Association (Progressive, Argument, at 2; Kingsway, Exhibit 4.8.6). Kingsway considered the Mercer surcharges for claims and convictions to be generally inadequate, and suggested that the result would be an increase in the Facility population of drivers with claims and convictions, as the voluntary market would be unwilling to insure such risks (Concluding Arguments, at 1-2).

7.44 Dominion stated in final argument that, if a claim is to be assumed to be a predictor of risk, the claim surcharge should apply to all moving coverages, rather than affect only the coverage under which the claim is incurred (Argument, at 1-2).

7.45 No insurer quantified any change in the level of claims and convictions surcharges as estimated by Mercer.

7.46 At the request of Board Counsel, Mercer undertook to estimate the impact of applying "effective" Facility Association surcharges to risks in the voluntary market who are subject to surcharges (Undertaking 4.11.5). Mercer estimated that this exercise would result in the addition, after calculation of all claims and conviction surcharges, of the following flat charges:

for third party liability, \$260; for accident benefits, \$30; and for collision, \$80 (Exhibit 4.11.2 to 4.11.5, Exhibit 3, at 5).

7.47 On re-direct by Board Counsel, and in cross-examination by Mr. Howard, and by Mr. Cumine, Counsel for the Facility Association, Mercer explained what it had done in response to Undertaking 4.11.5. It had calculated dollar values associated with the Facility differential of 1.5 (as recommended by Mercer) and applied them to the average pure premium of the total market as a flat addition (or base surcharge) to the existing total market accident/violation surcharges. Mercer had not calculated the additional surcharges with reference to the actual surcharging practices of the Facility Association today (Bass, Transcript, at 3707-08, 3715-16, 3743-45).

7.48 The Supplemental Decision of the Board in Hearing I-88-1A provided for forgiveness of one claim per policy year in the amount of up to \$700 (Supplemental Decision, at 11-12). Counsel for the Industry Coalition raised a definitional issue during the pre-hearing conference as to whether the forgiveness limit was to be applied on a per coverage or a per occurrence basis (Howard, Transcript, Pre-Hearing Conference, at

38-39). This issue is dealt with by the Board in its Partial Decision I-88-1D, dated January 20, 1989, at 5-7.

(c) Position of the CAC

7.49 The CAC submitted that the Mercer surcharges were not actuarially justified, and were therefore subject to error (Final Argument of the CAC, at 11):

... Claim and conviction surcharges were calculated in such a way as to 'approximate the charges used by the industry today' (p. 54) and to 'approximate current industry practices' (p. 58).

These current industry practices were developed in an unregulated environment without a uniform classification plan. At least some of these practices were responses to competitive considerations and there is no reason to assume that they are actuarially justified.

7.50 Nevertheless, the CAC agreed with the Mercer treatment of conviction surcharges.

7.51 As a complement to its recommendation that differentials for inexperienced drivers be reduced, (see paragraph 7.18), the CAC proposed that the surcharges for claims, as recommended by Mercer, generally be increased. However, the CAC was of the view that the \$260 flat surcharge for third party

liability, as calculated in Undertaking 4.11.5, was probably excessive, particularly when applied to a driver with one claim four or five years ago. The CAC recommended a more modest increase in claim surcharges, "perhaps \$25-\$50 for third party, \$3-\$5 for accident benefits, and \$5-\$10 for collision" (Final Argument of the CAC, at 15-16).

8. Increased Coverage Limits Factors

7.52 Because the IBC was unable to supply claims data separately by limit of liability for third party liability, Mercer departed from the data segmentation rate making approach approved by the Board in its Decision in Hearing I-88-1B, and proposed rates based on combined limits data (Exhibit 5.1, at 10). For purposes of estimating differentials among limits of liability, a survey of market differentials was conducted, and the averages of increased limits factors of the ten largest writers of automobile insurance in Ontario were selected for purposes of this rate making process (Exhibit 5.1, at 21, and Exhibit 15 thereto). A similar process was adopted for SEF 44 (Exhibit 58 to Exhibit 5.1). The Mercer process of estimation was not challenged.

9. Coverage Deductible Factors

7.53 In its Decision in Hearing I-88-1B, the Board determined that premium levels for different levels of deductible, including discounts and surcharges, should be established directly for each level by using loss costs that are specifically attributable to each level of deductible.

7.54 Although the IBC gathers data on a segmented basis for both comprehensive and collision, Mercer was unable, because of an apparent data anomaly, to follow the approach stipulated by the Board. Rather, Mercer took the following approach, as summarized in the Submission of Board Counsel (at 2/28 - 2/29):

... Mercer analyzed each segment separately by deductible, then combined the results based on a projected anticipated distribution of exposures by deductible. The aggregate average pure premium was then disaggregated by deductible based on application of current market differentials to establish the prices by deductible (Exhibit 5.1, p. 29).

7.55 The Mercer approach to pricing deductibles was not opposed, although, as outlined in Chapter 8, an issue arose concerning the application of the deductible factor in the proposed rating algorithm for collision coverage.

10. Rate Level Off-Balances

7.56 The "off-balance" is an adjustment designed to ensure that the classification differentials applied to the base rates combine to produce the province-wide average pure premium by coverage. That is, it is designed to ensure that no revenue is created or destroyed in the process of calculating differentials for the purpose of distributing the average province-wide pure premium by coverage among the classification cells (Exhibit 5.1, at 60-64; Bass, Transcript, at 207-08). The Mercer calculation of the off-balances by coverage is described in Exhibit 5.1, at 60-64.

7.57 With respect to the off-balance for multi-vehicle households, Counsel for State Farm questioned Mercer's assumption that 40 percent of the population would be entitled to the multi-vehicle discount. It was indicated that State Farm has an average of 65 to 70 percent who qualify for the discount. In the view of State Farm, the Mercer percentage should be higher if a revenue shortfall to the industry is to be avoided (Brown, Transcript, at 596-601; State Farm Argument, at 2).

D. COMBINATION OF DIFFERENTIALS

- 7.58 Mercer recommended that the differentials should combine multiplicatively, with the exception of the convictions and number of years claim-free/number of claims differentials, which should be additive. Mercer acknowledged that there might be some interdependence between the classifications. Nevertheless, in the absence of appropriate insurance data that would permit an estimation of the interrelationships, Mercer decided to follow industry practice, which is multiplicative, for all differentials but claims and convictions.
- 7.59 Parties representing the industry generally objected to the additive combination of claims and conviction differentials as a departure from industry practice. The CAC was strongly opposed to any multiplicative combination of differentials. Noting that the acknowledged difficulties with data underlying the estimation of classification differentials give rise to a serious possibility of error, the CAC pointed out that such errors would be compounded by a multiplicative system of combination (Final Argument of the CAC, at 10-11).

BOARD DECISION

7.60 Having considered the evidence, the Board finds that the treatment by Mercer of the classification differentials is both reasonable and acceptable in light of the data limitations. The Board accepts not only the Mercer estimation of the differentials, but also the manner of their combination, and the calculation of the off-balances. The reasons of the Board are set out in the following paragraphs.

1. Territory, Vehicle Use and Annual Driving Distance, Abstinence, Number of Vehicles in the Household, Increased Coverage Limits and Coverage Deductible Factors

7.61 The Board has considered carefully, and has rejected, the very limited evidence challenging the Mercer treatment of the abovementioned differentials. With respect, specifically, to the CAC suggestion that the differentials for medium and long distance business use be increased, the Board is unaware of any data upon which such an adjustment might be based, and accordingly opts in favour of the Mercer approach.

2. Years Licensed, Principal and Secondary Drivers
(Including Driver Training)

7.62 The Board accepts the Mercer estimation of differentials reflecting the driving experience of principal and secondary operators. The Board does not agree with the position of the CAC that the differentials proposed by Mercer for inexperienced drivers are excessive. The Board is satisfied that the available data indicates that inexperience is an important predictor of risk, and considers Mercer's estimations to be reasonable and supported by the results of their analysis of the available IBC data. Moreover, while the differentials are higher than those prevailing in Massachusetts, they are lower than those in use by the industry in Ontario today. Additional data available through the IBC, as well as data captured under the Board Statistical Plan, will be monitored carefully to determine whether any moderation of differentials for inexperienced drivers is justified.

3. Vehicle Rate Groups

7.63 For reasons set out in Chapter 10, the Board accepts

the VCS proposal concerning the grouping of vehicles and the quantification of the rate group relativities.

4. Convictions and Number of Claims/Number of Claim-Free Years

- 7.64 The Board accepts Mercer's use of current industry practice in the estimation of claim and conviction surcharges, as there was no other Ontario data available. In the future, however, the Board intends to explore fully the predictive nature of claims and convictions as they relate to loss costs. In the coming years, data will become available under the Board Statistical Plan that will provide the link between claims and convictions and loss experience.
- 7.65 As indicated in Chapter 4, a strong public sentiment in favour of increasing surcharges for drivers with claims and convictions was apparent in the correspondence and submissions received by the Board. In addition, many of the parties who appeared before the Board testified that the surcharges proposed by Mercer should be increased.
- 7.66 While there was no definitive evidence that the surcharges used in the voluntary market have been

inadequate, the extent to which the voluntary market in fact insures drivers with claims and convictions on the basis of industry surcharges was questioned. The suggestion was made that, in calculating surcharges, it might be more relevant to look to the surcharging practices of the Facility Association and non-standard insurers. The evidence also indicated that even the present Facility level surcharges have been inadequate for the Facility population. (See paragraphs 7.41 and 7.42.)

7.67 The Board appreciates that, if the surcharges were increased, insurers would be more likely to perceive the rates for drivers with claims and convictions as adequate. An increase in surcharges might assist in minimizing the Facility population. Further, increasing surcharges might have a positive effect on driving behaviour, as insureds take steps to avoid being surcharged.

7.68 On the other hand, the Board realizes that if surcharges are too high, some individuals may drive without insurance as their premium level becomes "unaffordable". The higher the surcharges, the greater will be the premium and market dislocation: if individuals' premium rates change drastically, they

will seek out other insurers. Moreover, the higher the surcharges, the greater the chance that double counting will occur, irrespective of whether a multiplicative or an additive method is used. A lower surcharge spreads the cost of any error, so that the error realized by any given individual will be smaller.

7.69 Having weighed carefully both the evidence and the advantages and disadvantages of increasing the claim and conviction surcharges proposed by Mercer, the Board has concluded that some increase in surcharges is appropriate. The Board notes that its modifications to the Mercer pure premium would result in surcharges below those proposed by Mercer as set out in Exhibits 68-71 of Exhibit 5.1.

7.70 With respect to the amount of the increase, the Board notes that, of the many parties who testified that the Mercer surcharges should be increased, only the CAC quantified any increase. The CAC suggested that the surcharges proposed by Mercer in respect of claims should be increased by \$25-\$50 for third party liability, \$3- \$5 for accident benefits, and \$5-\$10 for collision, as opposed to the flat increases calculated by Mercer pursuant to Undertaking 4.11.5.

7.71 The Board is aware that no industry-wide actuarially justified surcharge amounts have been calculated. Such a calculation cannot be made at this time due to insufficient data. The Board appreciates that, under a bonus/malus approach to surcharges, surcharges would not have to be actuarially justified, as they could be viewed as punitive rather than risk-related. The Board is unable to accept a pure bonus/malus approach at this time, since it has not heard evidence on the matter; bonus/malus will be an issue in a further hearing.

7.72 At the same time, while the Facility Association surcharging practice appears to have some statistical justification, the Board is not convinced that the claim and conviction surcharges for the voluntary market should be increased at this time to levels that would be indicated by the Facility experience. The Facility's book of business has dramatically different and more severe loss experience than that of the voluntary market. Since the indicated surcharge levels vary so greatly between the Facility and the voluntary market, and since the Facility represents only a small portion of the entire market, the Board is of the opinion that it would be inappropriate to apply Facility-indicated surcharge levels to the entire automobile insurance market.

- 7.73 The appropriate treatment, in the view of the Board, is to increase by 25% the surcharges indicated by the use of the Mercer methodology as adjusted by the Board. This would result in surcharges slightly in excess of those set out by Mercer in Exhibits 68 to 71 of Exhibit 5.1. The proposed claim surcharges are not dissimilar to those recommended by the CAC. The surcharges established by the Board for claims and convictions are contained in tables reproduced at the conclusion of this Chapter.
- 7.74 With respect to the use of additive or multiplicative surcharges, the evidence indicated that insurers generally preferred the use of multiplicative surcharges. However, both Progressive and the Facility Association indicated in written argument that they had no particular concerns with the use of the Mercer proposed additive procedure as long as the procedure generated adequate premium levels for surcharged risks.
- 7.75 Preference for a multiplicative method of surcharging appears to assume that such a method will produce, on balance, higher premiums for surcharged risks. This being the case, there will be a better chance that rate adequacy will be achieved for surcharged risks. While

it is generally true that surcharged risks will pay more under a multiplicative method, it is worth noting that Mercer calculated the additional premium generated by the insurance industry through the use of surcharges (which were generally levied on a multiplicative basis) and then converted these to an additive basis. Accordingly, the total premium generated by the surcharges would be unchanged as a result of this conversion.

7.76 In the view of the Board, the possibility of double counting, as between the claims and convictions classifications and, in particular, the driving experience classification, is particularly strong. Accordingly, the Board has determined that claim and conviction surcharges should be applied on an additive basis, as proposed by Mercer and supported by the CAC.

5. Off-Balances

7.77 The Board accepts the Mercer calculation of the off-balances. The Board has considered State Farm's contention that the Mercer assumption concerning the proportion of households that would qualify for the multi-vehicle discount is too low. Apart from information suggesting that State Farm's particular

book of business includes a higher proportion of insureds who so qualify, the Board does not consider that it has been presented with sufficient evidence to justify changing the Mercer assumption for purposes of this rating exercise.

6. Combination of Differentials

7.78 The Board accepts the Mercer recommendation that, with the exception of the two differentials for claims and convictions, the classification differentials should be combined multiplicatively. The Board considers that the most obvious dangers of double counting are removed by the additive treatment of claims and convictions. The Board agrees with Mercer that, in the absence of data that would permit an estimation of the interdependence between the classification variables, the better course is to follow what has been Ontario industry practice to date, and to combine the differentials multiplicatively. The Board will consider the issue again, however, in the context of future rate reviews.

TABLE 7-A

BENCHMARK
CONVICTION HISTORY SURCHARGES
=====

	Charge per Chargeable Conviction -----		
Coverage =====	Serious Conviction =====	Major Conviction =====	Minor Conviction =====
1. Third Party Liability	\$320	\$95	\$65
2. Accident Benefits	35	10	5
3. Collision	115	35	25

TABLE 7-B

BENCHMARK
VEHICLE CLAIM HISTORY SURCHARGES
=====

1. Third Party Liability

No. of Years Since Last Chargeable Claim =====	No. of Claims in Experience Period -----				Surcharge per Additional Claim =====
	1 =====	2 =====	3 =====	4 =====	
6 or more	\$0	\$0	\$0	\$0	\$0
5	25	50	75	100	25
4	50	100	150	200	50
3	75	180	285	390	105
2	100	305	510	715	205
1	125	435	745	1055	310
0	155	670	1185	1700	515

2. Accident Benefits

No. of Years Since Last Chargeable Claim =====	No. of Claims in Experience Period -----				Surcharge per Additional Claim =====
	1 =====	2 =====	3 =====	4 =====	
6 or more	\$0	\$0	\$0	\$0	\$0
5	4	7	10	13	3
4	6	11	16	21	5
3	8	18	28	38	10
2	10	30	50	70	20
1	12	42	72	102	30
0	15	65	115	165	50

3. Collision

No. of Years Since Last Chargeable Claim =====	No. of Claims in Experience Period -----				Surcharge per Additional Claim =====
	1 =====	2 =====	3 =====	4 =====	
6 or more	\$0	\$0	\$0	\$0	\$0
5	5	20	35	50	15
4	15	40	65	90	25
3	25	65	105	145	40
2	35	110	185	260	75
1	45	155	265	375	110
0	60	245	430	615	185

8. UNIFORM RATING ALGORITHM

- 8.1 In its Decision in Hearing I-88-1B, the Board decided that it had the jurisdiction to adopt a uniform rating algorithm for calculating individual policy premiums, and that, on policy grounds, such an algorithm should be adopted. In order to permit insurers to begin programming their systems, the Board adopted a generalized version of the algorithm, to be made specific in the course of the present hearing (Decision, at 103-04, and Appendix E thereto).
- 8.2 A technical committee was appointed to review the generalized algorithm for adequacy and completeness. The Committee submitted its report, dated November 4, 1988, and the report was filed as evidence in this hearing (Exhibit 7.1). The Mercer Proposal contains a specific application of the generalized uniform algorithm approved in the Decision in Hearing I-88-1B (Exhibit 5.1, at 64, and Exhibit 76 thereto).
- 8.3 Apart from the policy question, canvassed in Chapter 7, whether differentials should be combined additively or multiplicatively, the proposed uniform rating algorithm generated little discussion. Dominion, however, raised

an objection in final argument to the Mercer application of deductible factors, stating as follows (Final Argument, at 2):

If one accepts Mercer's proposition that claims and conviction surcharges should be additive (i.e. independent of all other rating factors), then the surcharge should not vary with the deductible chosen--particularly when the deductible level is a factor within the insured's immediate control which is unlikely to affect his claim propensity. We recommend that the Uniform Rating Algorithm be revised so that deductible factors are applied BEFORE the claim and conviction surcharges are added.

Board Decision

8.4 The Board agrees that the proposed application of the deductible factor has the effect of creating a much larger discount for a driver with multiple claims and convictions. The following example illustrates this effect:

Assume two insureds (A and B), each with identical classifications before claim and conviction surcharges, purchasing a policy deductible of \$2500 for collision coverage. Both insureds would have the same premium before claim and conviction surcharges. However, A has no chargeable claims and convictions, while B has a chargeable claim and conviction history resulting in surcharges of \$605.

Using the Mercer proposed factor of -45% for a \$2500 deductible limit (Item 2 of Exhibit 95 to Exhibit 5.1), B would receive an "extra" discount of \$272.25. While few drivers would fit the circumstances of this example, even if A and B were to purchase only a \$500 deductible B would still have an extra discount of \$66.55 due to the applicable deductible factor of -11%.

The Board does not believe that insureds with claims and convictions should be able to lessen the impact of claim and conviction surcharges by purchasing higher deductibles.

8.5 The Board notes, also, that in the algorithm for third party liability proposed by Mercer, the increased limits factor for third party liability coverages is applied before claim and conviction surcharges (Item 2, Exhibit 76 to Exhibit 5.1). The increased limits factor and the deductible factor are similar, in that they are used to calculate premiums for various levels or limits for different coverages. In the Board's view, it makes sense to apply both factors in a uniform manner.

8.6 For the reasons mentioned above, the Board finds that the algorithm for collision proposed by Mercer should be amended to apply the deductible factor before the

accident and conviction surcharges. The resulting algorithm would then be:

Collision Premium, begin with the \$250 deductible collision base rate and calculate:

$$\{[BR(t) * CV(u) * CV(e) * CV(a) * CV(n) * CV(v)] + VC + AC\} +$$
$$\{[BR(t) * CV(u) * CV(e) * CV(a) * CV(n) * CV(v)] * DC(d)\}$$

where $\{[BR(t) * CV(u) * CV(e) * CV(a) * CV(n) * CV(v)] * DC(d)\}$ is subject to a dollar maximum ...

8.7 Subject to this amendment, the Board adopts the uniform rating algorithm proposed by Mercer. The algorithm, as amended, is contained in Appendix F.

8.8 The rate order to be issued following the Decision contains text that describes the uniform rating algorithm in words. This text, together with tables provided therewith and the Class Plan Order, constitute instructions for rating each coverage for each automobile insured.

9. RANGE OF RATES

A. INTRODUCTION

9.1 The Act provides that the Board establish rates or rate ranges for automobile insurance. During the course of Hearing I-88-1B, dealing with rate making methodologies and related topics, evidence was presented by Mercer suggesting that the Board establish a range of rates, rather than a single set of rates, for each category of insurance and coverage. The purposes of ranges of rates, as set forth in that evidence (Hearing I-88-1B, Exhibit 5.14, at 4) are:

- (1) encouraging fair competition in a regulated industry framework;
- (2) minimizing insurance availability problems and limiting the role of the Facility Association to that of 'underwriter of last resort';
- (3) increasing the attractiveness of Ontario as a place to conduct the business of automobile insurance;
- (4) enabling the consumer to obtain maximum value for his/her insurance dollar;
- (5) minimizing unnecessary regulatory intervention;
- (6) minimizing the cost of regulatory compliance for insurers;
- (7) recognizing differences in skill levels (under-writing and claims) and in operating efficiencies among insurers; and

- (8) affirmatively recognizing the continued relevance of risk selection as an integral part of the conduct of automobile insurance in Ontario.

9.2 The Board stated that it would set "ranges of rates rather than specific rates, for classes of risk exposure" except that it reserved the right to establish a "single rate for a class of risk exposure where it considers this to be advisable" (Decision I-88-1B, at 112).

9.3 Mercer proposed that the width of the ranges of rates be established as a function of "true" market rate dispersion (Hearing I-88-1B, Exhibit 5.14, at 12-13; Transcript, at 1121-23). The Board determined that a study should be undertaken to determine existing true price dispersion among Ontario automobile insurers, including the Facility Association (Decision I-88-1B, at 113-14). Mercer undertook a study to determine this dispersion, the results of which are contained in Exhibit 5.1, at 106-17, and 229-56. The study conducted by Mercer consisted of a survey of current Ontario auto insurer rates for specific risk profiles (Exhibit 5.1, at 109). Due to time constraints, Mercer was able to complete this study only for the 15 largest writers of insurance in Ontario plus the Facility Association.

B. SIZE OF THE RANGE

- 9.4 Results of the dispersion survey indicated that, on average for all territories combined, the percentage of exposures within plus or minus 10% of the weighted average were: 45% for third party liability, 37% for accident benefits, 67% for collision, and 43% for comprehensive (Exhibit 5.1, at 249-52). Further, the Mercer Proposal stated (Exhibit 5.1, at 115):

From Exhibits 109-111 and 115-117, one can observe that the dispersion of rates is skewed to the low side of the average for TPL and collision.

- 9.5 On this analysis, Mercer recommended an asymmetrical range of +10% to -25% around the Board benchmark rates by coverage. The Proposal states (Exhibit 5.1, at 116):

This accommodates over 75% of the TPL exposures, 70% of accident benefit exposures, 80% of the collision exposures and 60% of the comprehensive exposures. Because these ranges will apply by coverage, the combined effect of the ranges will likely accommodate a much broader spectrum of the population than these.

Since one of the goals of establishing ranges of rates is to minimize the number of potential deviation requests, a range which can be anticipated to accommodate most of the true rate dispersion would be best. However, this must be balanced by the mandate of the

Board to regulate automobile insurance rates, so ranges beyond a certain size might be unacceptable.

- 9.6 Parties to the hearing adopted several different positions with respect to the size of the range. The CAC argued that the size of the range should be dependent on the size of the overall rate level increase. If the rate level is low, at the level recommended by Mr. Hunter in his competitive model, then an upward range of 10% would be acceptable, but in no event should any company be allowed to raise its rates more than 10% above the benchmark rates without prior approval of the Board.
- 9.7 The Industry Coalition supported the +10% to -25% range contained in the Mercer Proposal, especially in light of the difficult transitional issues to be faced by insurer and insured alike (Written Submission, at 6-7).
- 9.8 The IBAO presented evidence in support of a narrower downward range of rates. In oral evidence, Mr. Taylor stated that too much competition with respect to rates would result in an unstable market place, which would ultimately be bad for the consumer (Transcript, at 2689-90).

9.9 Gore Mutual favoured a range of rates of +10% to -10%, arguing that a wider range would not discourage irresponsible price competition (Exhibit 3.433, at 2-3).

C. APPLICATION OF THE RANGE OF RATES

9.10 In addition to a recommendation concerning the size of the range of rates, the Mercer Proposal contained a recommendation dealing with the application of this range. Insurers would be permitted to establish rates within the Board range in a variety of ways. Three options were identified (Exhibit 5.1, at 116-17):

- (1) Vary composite classification rating factors (only) by -25% to +10%;
- (2) Vary individual rates (only) by -25% to +10%; and
- (3) Vary both factors and base rates in any combination such that the two aspects together result in the final premium by coverage in the range of -25% to +10%.

9.11 During re-direct examination, Ms. Bass explained that the first option would apply the range around the composite of the rate differentials, not to individual differentials (Transcript, at 3326). With respect to option 3, she stated, in cross-examination, that the intent was for the range to apply to each individual classification cell separately (Transcript, at 685):

...the intention was that the range apply to the final rate, however the insurer gets there.

9.12 During re-direct examination, Ms. Bass outlined her recommendation concerning the manner in which the ranges of rates would apply (Transcript, at 3326-34). Ms. Bass considered option 2, which would permit an insurer to vary only the individual base rate, to be less flexible, as it would require a company either to move up or to move down its entire book of business (Transcript, at 3332-33). She stated that the first option would provide for insurer flexibility without restricting the Board's ability to regulate. When asked why insurer flexibility is important, she replied (Transcript, at 3331):

If an insurer wants to lower rates for some classes of risks but, if faced with having to make that decision for all risks or no risks, may choose to stay exactly where it is rather than lower its rate for every single risk and it would also cut down, I think, on the number of deviation filings that there might be.

9.13 With respect to the Board's ability to regulate, Ms. Bass stated that the Board should consider requiring an affidavit signed by an appropriate officer of the insurer stating that the company's selected rates

comply with the Board's range requirements (Transcript, at 3330).

9.14 The CAC favoured the second option identified by Mercer and argued that the range should be applied to the base rate by territory. This preference was based on a desire to facilitate production of a simple shopper's guide, which would take the form of a ranking of insurers by percentages above and below the Board's benchmark rates (Exhibit 22.1, at 21-22). The CAC argued that facilitating comparison shopping by consumers should take precedence over the desire to give insurers maximum flexibility. Finally, the CAC urged the Board, should it decide against the base rate approach to ranges of rates, to disallow any ranges about the claim and conviction surcharges (Final Argument of the CAC, at 19).

9.15 The CAC submitted that there is considerable informational and deterrence value in fixing consistent industry-wide surcharges. An insured's knowledge that a claim or conviction will result in a significant premium increase may have a positive impact on driving behaviour, particularly if the precise amount of the increase is known. Consistent fixed surcharges would also help drivers understand how their premiums are

calculated. The CAC further recommended that information concerning surcharges be widely disseminated (Final Argument of the CAC, at 16; Transcript, at 3728-34).

- 9.16 The Industry Coalition supported Mercer option 3, suggesting that insurers be permitted to vary their rates in any manner so long as the final premium by coverage and the expense constant were within the Board range (Written Argument, at 7). There was concurrence on this point by Safeco (Final Argument, at 7) and State Farm (Argument, at 2). It was stated that this option would reduce premium dislocation to individuals caused by the changes in the classification and rating plan.

BOARD DECISION

- 9.17 The Board notes that there was no evidence suggesting that the Board establish fixed rates rather than a range of rates. The evidence concerned itself, rather, with the size of the range and the manner of its application. With respect to these two aspects of the ranges of rates, the evidence focused on three major issues:

- (1) the Board's ability to regulate rates for automobile insurance effectively;
- (2) the insurer's flexibility in establishing its individual rate level; and,
- (3) the consumer's ease of comparison shopping based on price.

It is the delicate balance among these three concerns that forms the basis of the Board's decision on the range of rates.

9.18 In reaching its decision on the range of rates, the Board has considered the eight goals as set out in paragraph 9.1.

9.19 As indicated in Chapter 6, the Board finds that the upward bound of the range of rates should be 9% above the Board benchmark rates. This permits each insurer to establish its rates at the level of the actuarially indicated rates as determined by the Board. The benchmark rates, on average, recognize the future annual trend in loss costs. The range above this point allows for recognition of prior premium inadequacy (but

no recovery of past losses). It also provides for operating differences among insurers arising from such matters as differences in the book of business, and gives an opportunity to earn the allowed rate of return. It is the view of the Board that, in the current circumstances, an allowance of 9 percentage points above the benchmark provides a reasonable recognition of such factors, without permitting individual insurers, automatically and without prior Board approval, to establish rates in excess of the actuarially indicated rate level for the average insurer.

9.20 This upward bound is also consistent with the evidence presented before this Board by seven major writers of auto insurance in Ontario. Most indicated that they would be reluctant to implement a rate change greater than 20% at one time or even during the course of a single year. Thus, the actuarially indicated upper bound is consistent with the practical upper bound of insurers in Ontario.

9.21 As noted in Chapter 6, should the 9% upper bound prove to be insufficient for an individual company, that company has the right to file a deviation application with the Board. The Board expects, however, that this

upper bound will operate to keep the number of such applications at a practical minimum, and that it thus serves the goal of preserving the Board's ability to regulate rates effectively.

9.22 With respect to the downward range, the Board finds that the lower bound of the range should be established at 20% below the benchmark rates. The Board agrees with the IBAO that irresponsible price competition is not in the best interests of consumers (Transcript, at 2689-90).

9.23 The lower range established by the Board will permit insurers who are significantly more efficient than average to share these cost savings with the consumer without applying to the Board to deviate downward. These companies can choose to operate at a lower premium level without having to endure any significant regulatory protocol. However, below the -20% range, the Board is concerned that the differences between an insurer's intended rates and the Board's benchmark rates may not be supported by operating efficiencies, but may instead be the result of irresponsible price cutting in order to gain market share.

9.24 In establishing the lower limit of the range at -20%, the Board is also concerned to minimize the dislocation that will result from implementation of the Board Class Plan. A downward range of -20%, in conjunction with the Board's adoption of Mercer option 3 (discussed below in paragraph 9.28) will permit insurers to adopt rates significantly below the benchmark for classes of risk that are otherwise subject to large premium increases because of classification plan changes. As well, not all companies are currently operating at or above average rate levels. The depth of the range will prevent these companies from being forced to implement unnecessary price increases in order to come the within Board-approved range.

9.25 The Board will require any insurer intending to charge rates that are more than 20% below the Board benchmark rates to be subject to the prior approval process attendant upon a deviation application. Again, the Board expects that the lower bound will provide a range sufficient to encompass the majority of the market place, and does not expect the number of deviation applications to be so great as to hamper significantly the Board's ability to regulate effectively.

- 9.26 Turning to the application of the ranges, the Board is aware of the balance that must be struck between providing consumers with insurance price information in the simplest terms possible, and providing insurers with an element of rate flexibility. The encouragement of responsible price competition in the auto insurance industry is of primary concern to the Board.
- 9.27 Further, the Board notes that the level of uncertainty concerning the selected values for the rating differentials is significant. Although Mercer applied the Board's classification rate making methodology properly, the data itself precluded precise estimation of the rating differentials because of either data anomalies or lack of relevant data. This is central to the Board's decision to permit insurer flexibility in establishing the range of rates about the final premium, rather than the base rates.
- 9.28 The Board accepts that the CAC's recommendation to apply the range of rates uniformly by territorial base rate would lead to more easily understood consumer guides, but is of the view that its inflexibility may lead to a significant decline in responsible insurer price competition. Most insurers today, according to

the Mercer analysis, have rates skewed to the low end of the range (Exhibit 5.1, at 115).

9.29 Ms. Bass testified that an insurer, when faced with the choice of lowering rates for all of its risks or none of its risks, may opt to do so for none of its risks (Transcript, at 3331). The all-or-nothing approach required by Mercer option 2 would not, in the opinion of the Board, work to the benefit of insureds. Moreover, as stated previously, the Board wishes to encourage insurers to minimize the effects of dislocation caused by implementation of the Board Class Plan; this can best be accomplished by permitting insurers to adjust classification differentials selectively. Accordingly, the Board considers it advisable to permit each insurer to establish its rates separately for each individual classification cell to within +9% and -20% of the Board benchmark rates. This range will apply by coverage and will apply also to the expense constant.

9.30 The Board has concluded, however, that there should be no range around conviction and claim surcharges. The Board accepts the argument of the CAC relating to the value of fixing and communicating the Board surcharges for claims and convictions. In order that insureds may

understand precisely the effect of their actions in incurring claims and convictions, and in order to deter driver conduct leading to claim and conviction surcharges, the Board believes that insurers should not have the ability to vary such surcharges.

10. VEHICLE CODE SERVICE

A. BACKGROUND

- 10.1 The Board concluded in its Supplemental Decision I-88-1A that the new methodologies proposed by the Vehicle Code Service (VCS) will be used by the Board for the purposes of classifying private passenger automobiles (at 94).
- 10.2 VCS was to submit the methodologies and the resulting vehicle classifications for Board approval in advance of this hearing. The Board also requested assurances from VCS that the vehicle classifications will be updated on a regular basis. Specifically, VCS was to provide a semi-annual update for new models (for model years 1989 and 1990) and a quarterly update thereafter, as well as a default chart based on MSRP (Manufacturer's Suggested Retail Price) for purposes of assigning new models temporarily to rate groups (at 95).
- 10.3 Further, the Board indicated that VCS would be requested: to develop and maintain methodologies to classify other regulated vehicles for future use by the Board; to investigate the possibility of separate rate

groups for comprehensive and collision coverages; and to study third party liability loss costs by make and model, within each model year, for purposes of evaluating the merits of rating third party liability coverage on the basis of make and model (at 95-96). The Board believes that there is merit in completing these tasks.

- 10.4 The Board received the Vehicle Code Service Report on December 1, 1988. This report dealt with the initial procedure of determining the vehicle rate groups and factors for private passenger automobiles (Norup, Transcript, at 3025). Board Counsel, by letter dated December 6, 1988 (Exhibit 2.7(c)), asked questions relating to the report and requested that witnesses be made available. The response of VCS dated December 12, 1988 was filed as Exhibit 11.1. The Vehicle Code Service Report was appended to the response. A Supplemental Submission, dated December 21, 1988, and filed as Exhibit 11.8, included adjustments to some prior work plus the assignment of new models to rate groups. Exhibit 11.8 is the report that the VCS panel recommended to the Board (Norup, Transcript, at 3026-27). The panel of witnesses included Mr. Monte (IBC), Mr. Norup (Chair of VCS Committee), Mr. Pirie (Economical Mutual) and Mr. Yit (IAO).

B. VCS HISTORY AND ORGANIZATION

10.5 Vehicle rate groups have been used by the insurance industry for many years to classify automobiles of different manufacture, model, and age for rating purposes. "Price new" was an important factor in determining rate groups. During the last fifteen years, inflation had a great effect on the cost of new cars. The rating system of that period assigned cars to rate groups and hence to rate group factors depending only on price new. It was observed by insurers during this time that the relevance of the relationship between price new and loss costs was deteriorating. It was this that caused the insurance industry to investigate the possibility of introducing into the rating formula the relative damageability and repairability of the vehicles themselves. Damageability relates to the relative propensity of a vehicle to sustain damage when involved in an accident of a certain nature; repairability relates to the relative cost of repairing the vehicle once damage has been sustained.

10.6 Mr. Monte testified that rate groups based solely on a price new criterion have "two significant

shortcomings". The costs of repair are not necessarily related to price new. That is, a less expensive vehicle may be more costly to repair than a vehicle that costs twice as much. Secondly, the use of price new has the effect of penalizing individuals with vehicles that are more expensive as a result of having safety features (anti-theft devices, shock absorbing bumpers, etc.) designed to reduce claims (Transcript, at 3020).

- 10.7 The IAO introduced four digit vehicle codes in 1978 to accumulate experience by size, body type, and other distinctive features. This data, when coupled with vehicle MSRP's, provided a basis for more accurate rating of physical damage insurance coverage. This data served to modify the initial relativities based on price new, by reflecting the relative loss costs of vehicles with similar MSRP's. The IAO had initially used data from the Highway Loss Data Institute (HLDI) in the United States. Since January, 1985 it has been collecting and analyzing Canadian data, which is now considered to be credible (Supplemental Decision I-88-1A, at 90 and Volume II, Technical Committee Report, at 8/2 - 8/3; Transcript, at 3052-53).

- 10.8 VCS was formed in 1986 as an industry committee and joint venture of the Association of Canadian Insurers (ACI), Groupement Assureurs des Automobiles (GAA) in Quebec, the IBC, and the IAO. VCS decisions are made by a committee, consisting of representatives of the four sponsoring associations, an actuary, and a representative from insurance companies. It is supported by a staff drawn from the insurance industry. Before VCS, the IAO performed this service for its members only.
- 10.9 VCS establishes and publishes vehicle codes for statistical reporting purposes as required by the Superintendents of Insurance. These vehicle codes are later used to establish rate group factors based on loss experience (Minutes, VCS Committee, February 3, 1986, Undertaking 4.10.3; Monte, Transcript, at 3019). A second function of the VCS is to develop and publish vehicle rate groups (Minutes, VCS Committee, April 3, 1986 and July 2, 1986, Undertaking 4.10.3). These vehicle rate groups are used to differentiate the predicted loss costs for physical damage coverages (collision and comprehensive) for different vehicles. These rate groups are used to allocate the premium relating to collision and comprehension by make, model and vehicle age (Monte, Transcript, at 3019).

10.10 VCS is experience based, an ongoing service, and "dynamic". It constantly reflects new models and the experience of those models in use (Monte, Transcript, 3021-22). "We will continually review and recommend changes to the rating groups, sometimes on our own initiatives, other times responding to inquiries." (Norup, Transcript, at 3024).

C. NEW VCS METHODOLOGY

10.11 The VCS Report (Exhibit 11.1) describes the techniques used to develop the initial set of rate groups. Rate groups are established based upon individual loss experience by model. Canadian loss experience for accident year 1986 and 1987 is used exclusively for analysis. Each car is classified according to model, manufacturer, body type, drive train, size, and price range. Exhibit 11.8 contains a revised table of rating groups and new models.

10.12 The data base utilized by VCS is the last two accident years reported to the IBC. Any coding errors present in the IBC data base would carry forward to VCS (Yit, Transcript, at 3033). Although no independent audits of the data are performed by VCS, some reasonability

checks are carried out (Norup, Transcript, at 3034-35, 3072).

- 10.13 A revalidation check on the collision results of the data analysis was performed against HLDI data to verify the VCS approach. "Indications were similar for most models, with some variations ... because of different mixes of models, environment, etc. ..." (Exhibit 11.1, at 4-5; Transcript, at 3031-32).
- 10.14 No input from automobile manufacturers is used in the data analysis to set the rate groups, either for existing models or for recently introduced models. Information from manufacturers is used to classify the individual models initially (Transcript, at 3032-33, 3112-13, 3120-21).
- 10.15 The VCS methodology starts with raw data, smooths the data, fits it to an exponential model, and combines the outputs in order to produce a preliminary cost index (Exhibit 11.1, at 2; Transcript, at 3035-38).
- 10.16 The application of the methodology is explained in Exhibit 11.1, at 3, as follows:

Loss experience of each individual model is compared to the loss experience of all models

to establish a relativity index (the Vehicle Index) for each model (e.g. a Vehicle Index of 120 indicates the particular model has a loss experience 20% higher than a model with a Vehicle Index of 100). Additionally the loss experience of all models for an age group is compared to the loss experience of all models for all age groups, determining a relativity index (Age Group Factor) for each age group of models. The combination of these two factors yields the indicated differentials for individual models in each model year.

When new models are introduced, the existing Vehicle Index combined with the factor for age group 0 (i.e. new model) determines the new differential.

When new models, without any prior experience, are introduced, the Vehicle Index is determined from a grouping of similar type of models.

10.17 In developing the rating groups, three major assumptions are identified (Exhibit 11.1, at 1, Response to Question 1):

- (a) there is a consistent relationship between different models of vehicles within a model year (the Vehicle Index);
- (b) there is a consistent relationship between vehicles of different ages (the Age Group Index);
- (c) the Vehicle Index for any vehicle is affected by certain characteristics of that vehicle (namely,

body style, size, drive train, manufacturer, model and price).

10.18 Subsidiary assumptions made in applying the methodology are as follows (Exhibit 11.1, at 6):

- (1) variations in loss frequency and severity due to characteristics of risks not related to the vehicle (i.e., other classification factors such as driver experience and vehicle use) were removed;
- (2) in the minimum bias analysis for each model year and coverage, the relationships underlying the vehicle index and age index were assumed to relate multiplicatively;
- (3) "in the development of the average rate group relativity, it was assumed that model years 1988, 1989 and 1990 have the same distribution of vehicles as 1987"; and,
- (4) "it was assumed that the distribution of losses between comprehensive and collision coverages vary by age group but are fixed within an age group, age relating to the age of the vehicles".

10.19 In addition to the assumptions made, the following judgments were applied:

- (1) to override reversals in the data (Exhibit 11.8, at 1; Transcript, at 3026, 3047-48);
- (2) to cap vehicle indices, since the actual indicated relativities would lead to significant changes for some vehicles; changes in the rate group differentials were capped at minus 15% and plus 25%, with high performance vehicles capped at plus 45% (Exhibit 11.1, at 10-11; Yit, Transcript, at 3043-44); and,
- (3) to cap new car age indices to mitigate the effect on new car owners (Exhibit 11.1, Appendix 3; Yit, Transcript, at 3039-43).

10.20 VCS, in its response to Undertaking 4.10.2, indicated that capping was significant, in that over 40% of the vehicles (6,153, out of 14,477 vehicles) were capped. With respect to capping, VCS testified that the impact of the transition from the old price-based system to the new VCS methodology could be measured only against the IAO advisory rate groups since many companies may

use different rate groups. The impact, by vehicle, of the new rate groups "reflects the impact compared to [VCS] advisory rate groups". Therefore, the impact on market rates cannot be "completely ascertained". (Norup, Transcript, at 3045-46).

10.21 A question of "double counting" arose during the hearing vis-à-vis accident (claim) and conviction surcharges. An individual who drives a high-accident profile type of automobile, such as a high performance car, would pay relatively more because of the vehicle (per VCS rate groups), and again when accidents actually occur (through claim and other driver characteristic surcharges). For example, an operator driving a high performance automobile would pay a higher proportional premium for the car (that is, based on the historical higher loss costs of the vehicle), which might then be compounded by an inexperienced driver factor. Surcharge factors, if applied, would be a "double count" in that these factors are already reflected in the higher loss costs of the vehicle (per VCS rate group) (Transcript, at 3127-29).

10.22 Mr. Hunter, the witness for the CAC, was of the opinion that an offset for rate group drift had not

been provided for in the VCS methodology since the average rate group factor for comprehensive was less than 1.00 (Exhibit 22.1, at 13). Ms. Bass stated that an average factor less than 1.00 was not prima facie evidence that the VCS had failed to offset for rate group drift. She pointed out that VCS, in oral evidence, had explained that, by establishing estimated future distributions of cars, it implicitly considers rate group drift in its calculations. Ms. Bass stated that she could offer no opinion as to the appropriateness of the process VCS used to estimate the future distribution (Transcript, at 3745-47). VCS stated that it was satisfied that rate group drift is fully accounted for in its methodology (Transcript, at 3028-30).

D. VEHICLE INFORMATION CENTRE

10.23 In response to Undertaking 4.10.5, VCS filed a proposal for an organization that could accommodate the current VCS structure, the Board requirements, and the interests of various groups such as manufacturers and consumers.

10.24 Mr. Wizman, in his questions to the panel, indicated that, since vehicle rate groups will affect the cost

of insurance, consumers need information on the experience of vehicles to assist them in purchasing cars (Transcript, at 3076-79).

E. SUBMISSIONS ON VCS

- 10.25 In Hearing I-88-1A the Technical Committee recommended the adoption of VCS, as "the VCS methodology and data base is more appropriate for Ontario ... [and] appears to be a significant improvement over the current" MSRP approach (Supplemental Decision I-88-1A, Volume II, at 8/10).
- 10.26 Counsel for the Industry Coalition supported implementation of the VCS methodology in this rate hearing. It was submitted that the methodology could be refined as additional data is collected; that delay would force insurers to go through two transitions; that because the Mercer Proposal relies on VCS for some calculations, re-calculations would have to be done if VCS were not used; and that the VCS system is necessary to incorporate the high performance vehicle surcharge ordered by the Board in Supplemental Decision I-88-1A, at 46-47 (Written Submission, at 15).

- 10.27 State Farm also supported VCS in final argument (State Farm Argument, at 5). Counsel for State Farm urged, "Do not reject! We think that this is far superior to the current system ..." (Brown, Transcript, at 3936). It was submitted that, because VCS rating is based on vehicle experience, the methodology is more accurate and has the potential to promote safety. Manufacturers can choose to increase safety characteristics without penalizing individuals, because the cost of the vehicle will not be the only basis of the rating. However, State Farm recommended that the Board study and consider "model year rating", a system it currently uses, "as a potential improvement to the system" (Brown, Transcript, at 3937).
- 10.28 Gore Mutual (Exhibit 3.433, at 6) recommended the adoption of VCS "from inception" of the Board Class Plan.
- 10.29 Dominion recommended that the Board continue to use the current VCS method. There was some concern that "consumer dislocation" would be created by adoption of the new methodology. Further, the current system "is a known quantity", works "reasonably well and has not been the target of either consumer or industry

criticism" (Written Summary Arguments; Transcript, at 3955-56).

10.30 The CAC did not make any comments on this issue.

BOARD DECISION

10.31 Board Counsel submitted that the criteria to be applied by the Board in deciding whether to use VCS in this rate decision are accurate data, suitable methodology, and known impact (Transcript, at 3051-52; Submission, at 5/6). Mr. Norup agreed with this submission (Transcript, at 3052).

10.32 There was no evidence suggesting that the data was not suitable. In fact, the witness panel pointed out that reasonability checks and a comparison with HLDI data were done "to make sure that we are not totally out in left field" (Norup, Transcript, at 3032). They believed the IBC audits to be "fairly strong audits as far as vehicle codes are concerned ... in terms of consistency" (Yit, Transcript, at 3034). Further, even if there were coding errors in the IBC data base, these errors would not necessarily affect the analysis because VCS does not use all the same data elements (Norup, Transcript, at 3034).

- 10.33 The Board encourages VCS to use all available vehicle information, including any vehicle studies that might aid in differentiating vehicles as to their damageability, repairability and propensity to be involved in costly accidents. Such studies would include crash testing results.
- 10.34 Despite some concerns about the methodology, described below, the Board has decided to adopt the VCS proposal for purposes of this rating exercise. The Board believes that as more data becomes available, the new VCS methodology, once in place, and properly refined and controlled, has the potential to be a more useful rating tool than a system using price new. Price new is fundamentally flawed, as it does not accurately differentiate among vehicles on the basis of exhibited relative loss costs. The VCS methodology, on the other hand, does differentiate among vehicles on the basis of design characteristics, for example, damageability and repairability. The Board is concerned that, if it were to delay the implementation of what appears to be a more accurate method of classifying and rating vehicles, it would also be delaying the refinement of this methodology and would be using a methodology it knows to be inferior.

10.35 The insurance industry is generally in favour of using the new VCS methodology. The CAC made no submissions; the Board notes that the CAC was represented on the Technical Committee which recommended the use of VCS (see paragraph 10.25).

10.36 The Board believes that the VCS methodology is basically sound. However, not all the steps used by VCS have been fully tested. The Board is also concerned about the lack of evidence regarding the reasonableness of the vehicle rate group factors produced under the methodology. The Board did not supervise the process, and has some reservations concerning certain of the VCS assumptions and judgments.

10.37 With respect to the judgment applied by VCS concerning reversals, the Board would want VCS to explore all possible reasons why such reversals would occur. This is particularly important if the results show that certain reversals are consistent over time. Further, the Board is not convinced that the judgment applied by VCS as regards capping will, in fact, mitigate the effect of moving from the old to the new VCS methodology. The evidence indicates that many insurers

may not now follow the VCS advisory rate groups in their entirety. The Board is also concerned about the shifting of costs from new car owners to old car owners. If future data shows that new vehicles exhibit higher loss costs than allowed for by the smoothing of the new car indices, the Board will use the actual indicated new car indices.

10.38 The Board does appreciate that, over time and with increased data and more refined methodologies, fewer judgments will be required, although the necessity for the application of judgment will not disappear (Transcript, at 3125-26).

10.39 Finally, with respect to double counting, because data is not available under the Board Class Plan, it is not possible to determine whether poor driver characteristics are being surcharged twice, that is, once for claims and convictions and/or inexperienced driver rating, and then again for the same driver characteristics as reflected in the vehicle rate group class.

10.40 As noted above, paragraph 6.150, the Board has ordered VCS to remove rate group drift from the methodology.

- 10.41 Finally, the Board has reviewed the VCS proposal on the Vehicle Information Centre Organization. The Board was pleased to see that the proposal attempts to include a balance of interests. However, this proposal is at an early stage, and the Board will not commit itself to any specific role in the organization at this time.
- 10.42 Because the Board requires access to VCS methodology to an extent sufficient to allow a thorough understanding of all the methods employed in establishing vehicle rate groups, Board Staff will communicate regularly with and monitor the work of VCS. To enhance communication between the Board and VCS, the Board requests that the Board be placed on the distribution list of all material circulated by VCS. The Board does not require that it be a member of any VCS advisory committees at this time. However, the Board requests that it be sent the minutes of meetings for all such committees.
- 10.43 The Board will examine the methodology thoroughly before the next rate hearing. It will have selected audits of the methodology performed by either Board Staff or consultants retained by the Board. The Board will include a review of this class of risk exposure as an issue in the next rate hearing.

10.44 The vehicle rate group classes and their factors are shown in a Table at the end of this Chapter.

TABLE 10-A
PRIVATE PASSENGER AUTOMOBILE
VEHICLE RATE GROUP FACTORS

<u>Vehicle Rate Group</u>	<u>Factor</u>	<u>Vehicle Rate Group</u>	<u>Factor</u>
1	.05	51	3.075
2	.10	52	3.175
3	.15	53	3.275
4	.20	54	3.375
5	.25	55	3.475
6	.30	56	3.575
7	.35	57	3.675
8	.40	58	3.735
9	.45	59	3.875
10	.50	60	3.975
11	.55	61	4.100
12	.60	62	4.250
13	.65	63	4.400
14	.70	64	4.550
15	.75	65	4.700
16	.80	66	4.850
17	.85	67	5.000
18	.90	68	5.150
19	.95	69	5.300
20	1.00	70	5.450
21	1.05	71	5.600
22	1.10	72	5.750
23	1.15	73	5.900
24	1.20	74	6.050
25	1.25	75	6.200
26	1.30	76	6.350
27	1.35	77	6.500
28	1.40	78	6.650
29	1.45	79	6.800
30	1.50	80	6.950
31	1.55	81	7.125
32	1.60	82	7.325
33	1.65	83	7.525
34	1.70	84	7.725
35	1.75	85	7.925
36	1.80	86	8.125
37	1.85	87	8.325
38	1.90	88	8.525
39	1.95	89	8.725
40	2.00	90	8.925
41	2.075	91	9.125
42	2.175	92	9.325
43	2.275	93	9.525
44	2.375	94	9.725
45	2.475	95	9.925
46	2.575	96	10.125
47	2.675	97	10.325
48	2.775	98	10.525
49	2.875	99	10.725
50	2.975	100	10.925

11. FACILITY ASSOCIATION

A. DESCRIPTION OF THE FACILITY ASSOCIATION

11.1 The Facility Association (the Facility) is an industry underwriting pool which was established by the insurance industry and subsequently continued in 1979 by statute, now the Compulsory Automobile Insurance Act, R.S.O. 1980, c.83 (the CAI Act). Every insurer licensed to write automobile insurance in the Province is a member of the Facility and subscribes to its Plan of Operation. The Facility is often described as an "underwriter of last resort". Through it, owners and licensed drivers of motor vehicles who have been unable to obtain insurance in the voluntary market can purchase coverage. The Facility cannot decline a risk, although an applicant may decline to accept a quote for coverage. The Facility is an integral part of the OAIL.

11.2 The Facility has a Plan of Operation (Exhibit 9.7), which governs its structure, relationships among members and administrative functions. Its insurance operations are governed by the Servicing Carrier Manual of Ranges and Rates (Exhibit 9.1).

- 11.3 Policies for the pool are issued by a number of insurance companies who have been appointed as servicing carriers. They are responsible for handling all policy and claims service on behalf of the Facility. The premiums charged for risks in the Facility are uniformly applied by all servicing carriers according to the Facility rate manual. Servicing carriers are bound by the terms of the "Servicing Carrier Contract".
- 11.4 Every licensed broker in the Province is eligible to enter into an agreement with a servicing carrier under the Facility's Plan of Operation. The Board of the Facility appoints each broker to one company that operates in accordance with the broker's own marketing method (that is, employee, captive agent, independent broker). The broker is required to complete a "Facility Association Broker/Agency Contract" with the servicing carrier.
- 11.5 Insureds placed through the Facility represent approximately 2% of the private passenger automobiles in Ontario. In 1987, 88,000 automobiles out of a total insured population of 4.2 million were with the Facility. The premiums written through the Facility

averaged 6.3% of the total industry premium over the last five years.

B. APPROVAL OF FACILITY RATES - JURISDICTION OF THE BOARD

- 11.6 Before the Act was proclaimed, the Facility prepared and promulgated rates in respect of contracts of automobile insurance under the Plan of Operation, and filed the rates, the statistical evidence and other relevant information with the Superintendent (section 10(3), CAI Act). The Superintendent approved or disallowed the rates, or approved the rates subject to variation as prescribed by the order of the Superintendent (section 10(4), (5), CAI Act).
- 11.7 Section 32(1) of the Act repealed these provisions, and amended the CAI Act (the CAI Act, as amended). The Facility is obliged to prepare rates in respect of contracts of automobile insurance under the Plan of Operation but such rates are not to come into effect until they have been approved by the Board (section 10(3), (4), CAI Act, as amended).
- 11.8 Section 24 of the Act sets out the rate approval provisions for the Facility. On the day that the rates or ranges of rates set by the Board for the industry

under section 20(1) come into effect, all existing Facility rates are revoked (section 24(4)). In this circumstance, the Facility is required, within thirty days of the order being made under section 20(1), to apply to the Board for approval to promulgate a rate that is (1) the section 20 rate or within the section 20 ranges, or (2) not a rate or within the range which has been set by the Board under section 20 (section 24(5)). In this way the Facility is no different than any insurer that must file and use section 20 rates (section 22) or apply for a deviation to use rates outside section 20 (section 23).

- 11.9 Those parties, including the Facility itself, that made submissions on the jurisdiction of the Board to set Facility rates in this hearing were all of the opinion that the Board did not have the jurisdiction to set rates for the Facility at this time. They submitted that the Board must wait for the Facility to make its application under section 24(5), which application for approval of its rates must be made within thirty days of a section 20 rate order. Board Counsel also was of the opinion that the Board could not set Facility rates as part of this Industry-Wide Hearing.

Board Decision

- 11.10 The Board agrees that it does not have jurisdiction to set Facility rates in this Industry-Wide Hearing. The Board notes that it has the jurisdiction to review Facility rates on its own motion (apart from an application by the Facility for approval under section 24(5)), and following a hearing, the Board may then set Facility rates (section 24(3)). In the Board's view, this power may be exercised at any time. For instance, the Board could hold an industry-wide hearing under section 20(1) and a hearing under section 24(3) at the same time if the proper procedural steps were taken. The Act, however, does not contemplate that Facility rates can be set, in the normal course, as part of an industry-wide hearing.

C. ISSUES BEFORE THIS HEARING

1. Introduction

- 11.11 The Board heard extensive evidence from witnesses on a number of issues related to the Facility. The first major issue discussed during the hearing was the size of the voluntary market rate differential, compared to that of the Facility. These differentials determine

how much of the overall adjusted pure premium required for Ontario comes from those insured in the voluntary market, and how much comes from those insured in the Facility. Recommendations for the Facility market differential ranged through a differential of 1.00 (for third party liability and collision), put forward by CAC; to 1.50 (for third party liability and collision) put forward by Mercer; to differentials of 2.78 (for third party liability) and 2.08 (for collision), put forward by the Facility. The size of the differential is important in determining base rates at the voluntary market level; for example, a 1.50 Facility differential resulted in a voluntary market differential of .989 (Exhibit 5.1, at 77). The higher the former, the lower the latter.

- 11.12 The second issue related to the characteristics of the Facility population and whether it is confined to high risk drivers and vehicles. The evidence indicated that only 50 percent of the individuals in the Facility are surcharged for claims and convictions. The problem of "clean risks" in the Facility was discussed at some length, and substantiated by some anecdotal evidence of members of the public.

11.13 Finally, the elements which contribute to the size of the Facility, were considered. Rates in the industry as a whole affect the size of the Facility. Generally speaking, inadequate rates would result in growth of the Facility. The need for adequate industry rates, including surcharges, and ways to contain the size of the Facility, were also examined at the hearing.

11.14 In this Decision, the Board considers and decides only the first issue, that is, the Facility and voluntary market differentials for purposes of calculating the industry-wide rates.

2. The Voluntary Market and Facility Differentials-
Description and Jurisdiction

11.15 In Decision I-88-1B, the Board determined that the general rate making methodology was appropriate for determining industry-wide rates, which included the Facility. The loss data upon which the industry-wide rates are based included the Facility experience as part of the entire market.

11.16 The rate making methodology takes into account the relative contribution of voluntary market risks and Facility risks to industry-wide rates through the

determination of relativities or differentials based on a comparison to the current average industry-wide rates. Experience shows that Facility claims costs (and hence premium requirements) are greater than average industry claims costs. If no distinction were made for the Facility rate differential in setting industry-wide rates, the voluntary market would be required to generate premiums that exceed its average claims costs.

11.17 Setting industry-wide base rates utilizing the voluntary market differential results in more equitable rates to all consumers. If the Board did not distinguish between the Facility differential and the voluntary market differential, a type of "off-balance" would be created, that is, the premiums generated by the voluntary market would not be in accordance with its risk. Therefore, if the Board wishes to establish industry-wide base rates at the voluntary market differential level, the Board needs to fix a Facility differential in this hearing for that limited purpose.

11.18 A preliminary question arose as to whether the Board could fix a Facility differential solely for use in the calculation of the voluntary market differential in order to achieve some degree of equity between the two

markets given their comparative loss experience. In other words, the Board, in fixing the differential, should not thereby be binding other Boards with respect to the actual differential to be used in the Facility rates. For instance, this issue will arise again in the upcoming portion of this hearing which will determine industry-wide rates for other categories of automobile insurance.

11.19 Board Counsel submitted that the Board had a choice. Either it could decline to determine the Facility differential, or it could make a preliminary indication of the differential that the Board finds to be appropriate based on the evidence (Submission, at 14/12-14/13). The value of the second approach is that the differential could be used, if the Board considered it proper under the circumstances, to set rates or rate ranges under section 20 for the industry as a whole.

Board Decision

11.20 The Board considers it advisable to determine a differential for the Facility to be used to calculate the voluntary market differential for incorporation in the industry-wide rates. In the Board's view, it has

jurisdiction to determine this issue insofar as it relates to the setting of industry-wide rates.

3. Determination of the Voluntary Market Differential

- 11.21 The Mercer Proposal estimates a differential for the Facility to the average rate level and a differential for the voluntary market to the average rate level.
- 11.22 The Facility is considered in section 4 of the Mercer Proposal. Some adjustments were made to Mercer's figures in the course of the hearing. Initial indications were that the Facility's premiums were approximately 3.0 to 3.5 times the average market rates, depending on coverage (Exhibit 5.1, at 71; Exhibit 9.13(a)). Mercer removed observable risk differences (for example, the current classification criteria) from the base in order to be able to quantify the true underlying differences between the Facility experience and the voluntary experience.
- 11.23 The adjusted Mercer Proposal calculates the maximum true underlying differential to be 2.12 for third party liability and 1.84 for collision (Exhibit 5.1, at 74; Transcript, at 1469).

- 11.24 As a validation, Mercer compared the results of its analysis to market place evidence of the differentials. Facility premiums were compared with the weighted average shown in the rate dispersion study conducted by Mercer and described in the Mercer Proposal (at 229-48). The highest level of rate dispersion observed for the voluntary market was about 1.40 to 1.60 times the average voluntary rate (Exhibit 5.1, at 74; Khury, Transcript, at 373-74). The dispersion study did not include the Facility in this range, although Facility rates were provided separately on each worksheet.
- 11.25 Mercer recommended that the Facility differential be established at 1.50 times the average rate as a "reasonable initial approximation" (Exhibit 5.1, at 75); "...the effective maximum in the marketplace today is an area of 1.4 to 1.6, so we selected 1.5. 1.5 is not magic." (Khury, Transcript, at 373).
- 11.26 Mr. Khury, the Mercer witness on the Facility issue, testified that the 1.50 differential was "on the edge of adequacy" (Transcript, at 406). It was his opinion that it would be preferable for the Board to err on the side of inadequacy, since if overall rates were adequate but the Facility rates were on the edge of adequacy, the difference would be made up in the

voluntary market rates. Mr. Khury observed
(Transcript, at 409):

... I am guessing probably on the short end
... probably too low ... if you don't know,
guess too low as opposed to guessing too
high. Too high I think is an incentive to
populate the Facility.

11.27 Mercer further recommended that the same overall rate differential apply to all classifications, territories and coverages since there is no data available to determine differentials at this level of specificity (Exhibit 5.1, at 75).

11.28 Once the Facility differential was selected, Mercer estimated the size of the Facility in 1989. Mercer assumed that the Facility would continue at its present size (2% of private passenger automobiles).

11.29 Based on the Mercer recommended Facility differential of 1.50, and its assumption that the Facility market share would remain at 2 percent, Mercer established the voluntary market differential at .989 (Exhibit 5.1, at 77).

11.30 The Facility presented extensive written evidence and gave testimony on the inadequacy of the 1.50

differential proposed by Mercer. The Facility argued that its past experience and book of business should be considered in establishing Facility rates directly or as a differential to the voluntary rates. Evidence presented by the Facility showed that the composition of the Facility in terms of driving record, by rating class and geographic territories varied from the industry average. Loss costs per vehicle also varied between the Facility and industry by rating class and driving record (Transcript, at 1397-1403; Exhibit 9.8). Evidence submitted by the Facility indicated that the concentration of higher than average risks in the Facility produced higher loss costs than the industry average.

11.31 The Facility stated that the calculation of the relativities of 2.12 for third party liability and 1.84 for collision, which were the basis of the Mercer recommendation of the 1.50 differential, were flawed. There were three key differences in the methodology used by the Facility. The Facility used differentials reflecting Facility experience instead of industry differentials in adjusting for the business mix of the Facility. Mercer used country-wide distribution factors whereas the Facility used Ontario distribution factors. Finally, a three year average of

distribution amounts was used by Mercer, while the Facility used only the 1987 distribution. Using the Facility methodology and data resulted in relativity factors of 2.78 for third party liability and 2.08 for collision (Submissions, at 13; Exhibit 9.13(a)).

11.32 The Facility also disagreed with the selection of the 1.50 differential as the mid-point between a differential of 1.00 (in which case voluntary market risks and the Facility risks would be contributing in the same proportion to the overall base rates) and the Mercer calculated maximum relativity of 2.00. A differential of 1.00 from the benchmark rate would put the Facility below the companies which choose rates above the benchmark. The Facility also disagreed with the proposal that Facility rates act as a "cap" or "ceiling" to the voluntary market. It did not believe that the Facility should be positioned at the point where the maximum voluntary market rates are located relative to average market rates (Submissions, at 14-15).

11.33 The Facility pointed out in its Submissions that, with a benchmark rate of 20% above the current industry average and with a 1.50 differential for all classes of risk, Facility rates would have to be reduced 10

percent from the current overall level. The Facility submitted that this would cause premium inequities both within and outside the Facility (Submissions, at 17-18).

11.34 The Facility pointed out that in certain territories its rates currently are lower than the voluntary market, since regulation did not allow them to implement the two 4.5 percent increases allowed in 1988 (and mandated certain specific types of rate rollbacks). The Facility is currently using January, 1986 rates based on July, 1985 statistics (Transcript, at 1412). The Facility anticipates that it will introduce evidence in its rate hearing which establishes the need for its recommended differentials (Transcript, at 4034). However, Counsel for the Facility, Mr. Cumine, did submit in oral argument that a 2.20 differential "would put [the] Facility ... into the position that it would have been in had it had the two 4.5 percent increases..." (Transcript, at 4034).

11.35 Representatives of companies writing primarily in the voluntary market recommended that the Facility be self-supporting and that Facility rates be based on its own experience. This would ensure that there would not be

cross-subsidization by the voluntary market of Facility risks.

11.36 Dominion, Allstate and Safeco submitted in their written arguments that the Facility rate differential of 1.50 was inadequate. Allstate and Dominion recommended a rate differential of no less than the current ratio of 2.00. Safeco recommended that the rate differential be set "at the level of indicated need" (Final Argument, at 8).

11.37 The non-standard insurers (see Chapter 12), represented by Kingsway, Pafco and Progressive, were all of the view that their rates should be based on the Facility rates (Kingsway, Transcript, at 4003; Pafco, Transcript, at 2819; Progressive, Transcript, at 4008). In their view, there must be sufficient room between the top of the Board-set range and the Facility rates to allow the non-standard companies to compete (Kingsway, Transcript, at 2780-1; Pafco, Transcript, at 2817; Progressive, Transcript, at 1804).

11.38 Mr. Star testified that a differential of 1.50 for the Facility would not allow non-standard insurers to operate in the high risk field. He recommended a

minimum differential of 2.00 for the Facility (Transcript, at 2780-81).

11.39 The actuarial consultant to Pafco calculated a minimum differential of 2.00 for third party liability and 1.50 for collision based on company-specific information. The President of Pafco, Mr. McIntyre, testified that given the current mix of business, Pafco would require rates of approximately two times the standard market rate. If the Facility differential was set at 1.50 it would be unprofitable for Pafco to remain in business. Mr. Belton, Vice-chairman and CEO, recommended that the differential for the Facility be a minimum of 2.00 (Transcript, at 2801-19).

11.40 Mr. Hunter, the CAC witness, testified that he agreed with the arguments put forward by Mercer and its recommendation of 1.50 as the Facility differential. He did express concern, however, that individuals with clean driving records would be placed in the Facility, and recommended that these drivers should have a rate differential of 1.00.

11.41 The CAC argued, however, that since standards cannot be established by the Board immediately to determine which individuals should be placed with the Facility, the

rate differential for the Facility should be set at 1.00. By setting the Facility differential at 1.00, the underwriting process, using intangible factors to rate individual risks, would not be allowed to function to the possible detriment of consumers (Final Argument, at 22).

11.42 The evidence establishes that rate requirements in the Facility have historically been higher than those in the voluntary market. The Facility indicated that a differential of at least 2.20 was required, based on certain assumptions with respect to industry-wide rates, in order to keep the Facility at or above the maximum rate which could be charged in accordance with industry-wide benchmark rates and ranges. Representatives of the non-standard insurers argued in support of a differential of not less than 2.00. The thrust of the evidence of the companies that operate primarily in the voluntary market was that the differential should be relatively higher, as opposed to relatively lower, given the nature of the loss experience of the Facility.

11.43 Mr. Khury stated that "there [was no] canned answer" as to whether a 1.50 or 2.00 differential was preferable and elaborated (Transcript, at 545-46):

I only urge that it be sufficiently higher than the overall average to permit some significant rate dispersions and let the marketplace work - it tends to find its level of equilibrium - and not to be so low as to really kill that. Now whether 1.5 does that or 1.9, I really don't know and if I could advise the Board anything - don't make it too low.

11.44 The Board has considered the proposal of the CAC that the differential be 1.00. The Board notes that it will be at least several years before data will be available to the Board which will allow it to have substantial confidence in its differentials by class. The Board shares the concerns of the CAC about the functioning and effects of the underwriting decision and, in particular, whether the Board Class Plan will be abused to the detriment of consumers. Companies will place themselves to compete in the market utilizing the rate ranges. If the differential for the Facility were established at 1.00, the maximum market rate would become 1.00, and companies could only compete in the range below the benchmark rate. In Mr. Khury's view, this would disrupt the functioning of the market (Transcript, at 3405):

It's a very large argument why the Facility rate differential being set at one just completely rearranges all the premises of doing business in the province.

Board Decision

- 11.45 The Board has determined that a preliminary rate differential should be set at this time for the Facility in order to determine the industry-wide rate. If a rate differential for the Facility is not set, customers in the voluntary market will pay higher premiums than would otherwise be required.
- 11.46 The Board is setting Facility rates insofar as the Facility can place itself within the rates and ranges set in this industry-wide hearing. The Board is not setting a Facility differential for use by the Facility. The Facility could choose to use this differential in the rates submitted to the Board for approval, or any other differential. This matter will be considered de novo at the Facility-specific rate hearing.
- 11.47 The Board is of the opinion that it should be particularly cautious about the selection of the Facility differential in these early years. However, should the Facility differential be determined in a Facility hearing to be different from that fixed in this Industry-Wide Hearing, it was Mr. Khury's opinion

that "the area of the difference and the off balance [for the voluntary market] is so small it can wait until the next round of rate setting" (Transcript, at 3664).

11.48 In the Board's view, the Facility differential should be greater than 1.00. The Board thinks it prudent to acknowledge the current relationship between Facility and voluntary market rates and to allow the market place to function for the next year. In the meantime, the Facility book of business can be closely scrutinized at the Facility rate hearing and detailed consideration can be given to either remedial measures for abuses in the market place, or mechanisms which prevent abuses in the market place.

11.49 In the Board's view, a Facility differential of 2.00 is advisable for use in calculating the voluntary market differential. This results in a voluntary market differential of .979 which has been incorporated in the benchmark rates adopted by the Board in this Decision. This Facility differential is at the high end of the possible range contemplated by Mercer. The Board rejects, for these purposes, the higher differential suggested by the Facility as it appears to be based on

the existing classification system and is therefore of questionable value for these purposes.

11.50 The Board anticipates that the Facility will apply to the Board for approval to promulgate rates very soon after the coming into effect of the industry-wide rate order flowing from this Decision. The Board would welcome such an initiative and will expedite the required hearing. Given the importance of the Facility to the market place, the Board, on its motion, will proceed to review the rates of the Facility should that become necessary in the interim.

12. NON-STANDARD MARKET

- 12.1 The automobile insurance market place is composed of insurance companies (the voluntary market) and the Facility. The Facility, established by legislation, is composed of all insurers and acts as the insurer of last resort (see Chapter 11). As a matter of practice, insurance companies have divided the voluntary market into two segments, the standard market and the non-standard market. There has been no legislative recognition of these two segments.
- 12.2 The standard companies make up the bulk of the industry. The non-standard insurers provide an alternative to the Facility for some drivers who are unable to obtain insurance from the standard insurers. In theory, the non-standard companies write drivers who have a claim and conviction history that makes them unattractive risks for the standard market, "but whose level of risk warrants a lower premium than that offered by the Facility" (Pafco, Final Argument, at 1).
- 12.3 The non-standard insurers have been represented throughout the Industry-Wide Hearing by Kingsway, Pafco and Progressive.

- 12.4 Progressive defined the non-standard market, but stated that the critical definition is that of a "non-standard programme: a programme of insurance designed to meet the special needs of ... high-risk customers or difficult to place" drivers (Argument, at 5).
- 12.5 Pafco provided a gloss on the usual understanding of a non-standard insurer. Pafco submitted (Final Argument, at 1) that:
- ... in reality, the nonstandard market is merely a segment of ... the 'residual' market. This market ... [consisting of] 'high risk drivers' is served partly by the Facility Association, partly by the non-standard insurers who operate exclusively in this market segment and partly by facilities which some standard insurers make available separately from their standard operations.
- 12.6 This view of the non-standard market is consistent with the approach adopted by the non-standard insurers with respect to the issue of rate levels for the non-standard market. All three non-standard insurers submitted that the Board should establish separate rates for the non-standard market, which should relate to the Facility rates (Kingsway, Transcript, at 4003; Pafco, Transcript, at 2819; Progressive, Transcript, at 4008).

12.7 Kingsway submitted that rates for the Facility should be based on Facility experience. Facility rates would provide the basis for non-standard rates, with non-standard insurers operating within a 25% downward range from the Facility rate level. Kingsway also suggested that rate differentials for the standard market and the Facility should be different, and that non-standard insurers should use the Facility differentials (Concluding Arguments; Transcript, at 4000-07). Mr. Star testified that Facility rates and non-standard market rates should both be developed separately from those set for the standard market (Transcript, at 2760, 2758).

12.8 Pafco also submitted that Facility rates should be based on Facility experience and not on industry experience. Because Pafco viewed Facility rates as a "cap or upper limit for the rates charged by non-standard insurers", it was Pafco's submission that the rate levels for the non-standard market could not be established until the Board had set the Facility rates. Pafco submitted that non-standard insurers should be permitted to charge rates within a downward range from Facility rates. Pafco also suggested that the Board consider the concept of a "single, discontinuous range", with separate bands for separate markets. The

range could be established, for example, from -25% to +250% of the benchmark rate. Standard insurers would operate in the band from -25 to +10, non-standard insurers from +170 to +200, and the Facility from +200 to +250 (Final Argument; Transcript, at 3983-99).

12.9 Progressive submitted that there should be a special non-standard benchmark and associated range, with the Facility at the top and the standard market at the bottom. In the alternative, non-standard insurers could operate in a downward band from Facility rates (Argument; Transcript, at 4007-15).

12.10 The non-standard insurers appeared to be of the view that they would always operate above the range set by the Board under section 20, since that range is set for the standard market, whose experience is different from that of the non-standard market. A common concern was that failure to establish a separate range for non-standard insurers would force them inevitably to apply for upward deviations. Since upward deviations always require a hearing under the Act (section 23(2)), non-standard insurers would be subject to costs in terms of both time and money that are not imposed upon all standard insurers. It was submitted that requiring an upward deviation was discriminatory and and unfair to

non-standard insurers, as it forced them to apply for a deviation to carry on their present line of business (Kingsway, Concluding Arguments, at 4).

- 12.11 One other concern, articulated by Progressive, was that requiring non-standard insurers to apply for an upward deviation would result in company-specific ROE regulation by the Board. Other insurers would be able to earn any rate of return, depending on their efficiency levels, as long as they stayed within the rate ranges established under section 20. But any company filing a deviation would have its ROE capped. It was submitted that non-standard insurers take more risk by definition, but would not have the opportunity to earn a commensurate return (Argument, at 4, 7; Transcript, at 4008). Mr. Rogacki agreed that if the Board were not tied to the industry-wide underwriting margins, then his "argument falls apart" (Transcript, at 4010).

BOARD DECISION

- 12.12 There is no issue before the Board regarding non-standard insurers that requires a decision.

- 12.13 The Board's hands are tied in relation to what it can do for the non-standard market at this time in this Industry-Wide Hearing. The Board is bound by the Act. Notwithstanding the very liberal interpretation of the Act provided by Mr. Belton and Mr. Star, the Board is of the view that it does not have the jurisdiction to set separate rates for non-standard insurers in an industry-wide hearing; nor can it set Facility rates in this hearing (see Chapter 11).
- 12.14 Therefore, all insurers, including the non-standard insurers, will be bound by the section 20 rates or ranges set by the Board in this hearing. All insurers have the right to make an application for a deviation upward from the rates or ranges set under section 20.
- 12.15 The Board, in its Decision I-88-1B, stated, "in principle ... it is desirable that non-standard insurers continue to operate in the market place" (at 135).
- 12.16 The Board recognizes that non-standard insurers have served a legitimate and useful role in the insurance industry and that they have provided a necessary service to a certain population of insureds. The Board also appreciates that non-standard insurers may be

deserving of a rate of return reflecting a "higher" risk. The Board in a deviation hearing would have to be convinced that a higher risk does in fact exist.

- 12.17 With respect to deviations, the Board points out that, in setting rates on a deviation application, the onus is on the insurer to demonstrate to the Board that the proposed rate is just and reasonable and not excessive or inadequate, and that the circumstances of the insurer justify the use of the proposed rate (section 23(8) of the Act). The Board understands why insurers might be concerned about approaching the Board for a deviation, particularly if their underwriting margins are better than the industry-wide margins. However, the Board is not estopped from accepting another underwriting margin for the purposes of an individual company's rates as long as the resultant rates are just and reasonable and not excessive or inadequate, and the insurer has convinced the Board that the circumstances of that particular insurer justify the use of the proposed rate.

13. MISCELLANEOUS

A. CORPORATE STRUCTURE AND RATE MAKING

13.1 In Decision I-88-1B, the Board considered the nature and extent of information that should be required of applicants for deviations from the rates set by the Board under section 20 of the Act. With one exception, the Board decided to use the deviation procedures recommended by Mercer as the basis of its information requirements (paragraph 8.14). The exception pertained to a portion of the "General Instructions" to the applicant, which stated (Exhibit 11 to Exhibit 5.1 in Hearing I-88-1B):

2. If the individual insurer applying for a deviation is a member of an insurance group and if other companies in that group have direct written premium from Ontario auto for the subject major automobile line of business, then the attached filing must be completed separately for EACH member company for the major line, whether or not the other member companies are included in the deviation request. As an alternative to providing individual company experience for those members not included in the deviation request, the experience of the combined group may be substituted.

"Insurance group" was not defined. The Board decided that it has the jurisdiction to require group filings

(paragraph 8.16), but declined at that time to decide whether group filings should be used as a means of determining whether subclassification on prohibited grounds is occurring (paragraph 8.17). The Board concluded:

8.18 There may, however, be other valid reasons why the Board should have information concerning the rating procedures and financial practices and condition of other members of a group to which an applicant for a deviation belongs. It may be useful, for example, for the Board to have information concerning the allocation of expenses among the members of a group. The Board has determined that the question of the utility and the propriety of requiring group information should be referred to Hearing No. 4.

13.2 Before considering the evidence in this hearing on this subject, it may be helpful to state the concern underlying the remedy of group filings, that is, the concern with "subclassification."

13.3 In Decision I-88-1A, the Board stated that the Act contemplates only one classification plan for the OAIL (subject to exemptions permitted by the Board) and that, in the Board's opinion, this means that subclassification is not permissible under the Act (paragraph 5.5). Applicants for insurance can be rated only on the basis of the classes of risk prescribed in

the Board Class Plan. If an insurer is of the view that the rate for that applicant is not adequate given the application of underwriting judgment by that insurer, then the insurer can only decline the application. The applicant cannot be rated on the basis of a non-prescribed class (for example, occupation or number of years insured by that insurer).

- 13.4 Prior to the coming into force of the Board Class Plan and Board-set rates, classification is unregulated and therefore subclassification is allowed within a single insurance company, let alone a group of related companies. In fact, many companies are affiliated with others through common ultimate ownership and insurers within those groups can have distinct and different target markets. For instance, representatives of the Royal who gave evidence at this hearing described three companies within the Royal group, two of which operate in Ontario. One of those two - Western Assurance Company - insures only those who have at least ten years driving experience, and its rates are lower than those of its affiliated company (Royal) for comparable risks (Transcript, at 1851-52). The following reasons were given for this type of separation, which Mr. Elms observed was "not unique" in the industry (Transcript, at 1870-71):

... it would be a little bit difficult to manage two separate sets of rates in one company....

....

... The Royal ... has a very, broad, very liberal underwriting approach ... That makes it difficult to select out the best drivers and offer them a better rate....

....

... Western could also be used for an experiment with certain business options that might not be feasible within the Royal....

Representatives of Safeco (which operates as a branch in Canada) confirmed that it has "two markets" in Ontario currently written by the branch. It is contemplating the incorporation of a Canadian subsidiary to write one of the markets (Transcript, at 1685-90). Safeco explained its rationale as follows (Transcript, at 1687-88):

Q. So as I understand Safeco's business plan, it is to offer a rate for what it considers to be the safer risks in Ontario and that will be presumably within the range fixed by the Board; is that fair?

A. It would be within the range, but the probability of what you call a safer risk will be charged a lower rate within the range than would other risks --

Q. And so you are going to have a second company - Safeco 2 we will call it - Safeco 2 plans to charge a different risk a different

price. Is that what you are saying, or is it the same risk, a different price?

A. No, it would be a different risk.

Q. Then why do you need a second company for the different risk?

A. Well, because the Class Plan can only deal with rating criteria, they cannot deal with underwriting criteria. And when we underwrite a risk, that underwriting process includes factors other than rating factors.

The Class Plan can only deal with rating factors. One of them was mentioned this morning in a Facility context of type of vehicle. That can, in our view, represent a different risk.

13.5 The evidence in Hearing I-88-1B (all excerpted in Exhibit 6.2) focused on specific bases for classification that will be prohibited under the Board Class Plan in accordance with section 33(1) of the Act, that is, age, sex, marital status, family status and handicap. The nature and dimensions of the underwriting decision were outlined in this hearing (for a summary, see Submission of Board Counsel, paragraphs 2.85-2.90) with respect to the Facility Association. In the Board's view, that evidence is also relevant to the type of decision making used in both structuring and operating corporate groups. Subclassification, therefore, may occur on many bases in addition to those prohibited under the Act. In what

circumstances, and the extent to which, sub-classification will occur, are of concern to the Board.

13.6 In this hearing, Mr. Seeney and Mr. Johansson of Board Staff gave evidence concerning the utility to the Board of group information and raised a number of underlying concerns in addition to subclassification. In essence, it was their view that when the Board is considering the circumstances of an individual company (for example, in a rate deviation application), the Board must be in a position to ascertain and understand all matters relating to the financial position of that company (Exhibit 8.1, at 7). The Board must be particularly concerned with decisions or transactions affecting the company that are not made at arm's length. This can occur in circumstances where companies are related by ownership or by common management and, therefore, information on entities that are "related" by either common ownership or common management or both must be obtained. This information, because it could relate to companies within a group that are not insurance companies carrying on business in Ontario, potentially goes well beyond the information that Mercer proposed be collected in the application for a rate deviation (paragraph 10.1). Board Staff did not present either a definition that

would capture the "group" adequately or the specifics of the information to be collected.

Board Decision

- 13.7 In the Board's view, the importance of understanding the financial position of a company and the importance of maintaining the integrity of the Board Class Plan cannot be overestimated. The Board, however, does not think that it is advisable to separate the policy question of whether group filings are necessary to achieve the Board's statutory mandate and objectives, from the complex and practical questions of how this can best be done.
- 13.8 The Board therefore agrees with the submission of Mr. Howard on behalf of the Industry Coalition (Transcript, at 3880). In particular, detailed information can be time consuming and costly to generate and it may be of limited utility if too wide a net is cast. The Board must have an opportunity to assure itself that any standard information requests it makes are based on a real "need to know" and the selection of pertinent information.

13.9 From this vantage point, it is not clear how many applications for a rate deviation the Board will receive, and what the basis of those applications will be. Further, the Board cannot be certain of the degree to which insurance companies will take organizational or re-organizational steps that would suggest a subversion of the Board Class Plan. In the Board's view, it is prudent to defer the adoption and implementation of a specific and detailed group filing requirement until the matter can be further studied by the Board and some experience with rate deviations and developments in the market place with respect to classification and underwriting can be acquired.

13.10 It was noted in evidence that this problem has been faced in other jurisdictions with rate review systems, for example, Florida (Transcript, at 3153-54), although very few jurisdictions have a uniform classification plan. Further, non arm's length transactions and dealings are of concern to the Superintendents of Insurance. There may be some useful precedents to draw upon in the insurance regulatory system generally, for example, the Model Insurance Holding Company System Regulatory Act and model regulations thereto adopted by the U.S. National Association of Insurance Commissioners.

13.11 Insurers should not be tempted to draw the conclusion from this deferral that the Board will not pursue concerns that it has about inter-corporate practices or dealings on a case-by-case basis. In an application for a rate deviation, the onus is on the insurer under section 23 of the Act to demonstrate to the Board that the proposed rate is just and reasonable and not excessive or inadequate, and that the circumstances of the insurer justify the use of the proposed rate. It is entirely possible that questions relating to inter-corporate practices or dealings could arise in upcoming rate deviation applications and the implications of the onus being placed on the insurer/applicant should not be overlooked. Further, the powers and duties of the Board, as outlined in section 12 of the Act, are broad and include powers of inquiry and inspection.

13.12 The Board directs that paragraph 2 of the General Instructions for the rate deviation application forms adopted by the Board in Decision I-88-1B be deleted and the General Instructions revised accordingly. The Board also directs that item number 4 in the part of the form headed "General Information" be amended as follows:

4. (a) Attach a chart presenting the identities and interrelationships among all insurers and other entities (whether incorporated or not) which are affiliated with the company by ownership, identifying all insurers and reinsurers as such.
- (b) Identify all affiliated insurers which carry on the business of automobile insurance in Ontario (not industry insurers whose licence is limited to contracts of reinsurance).
- (c) If the company is managed by persons other than its own employees, identify the manager (whether incorporated or not).
- (d) If the manager also manages the business of other companies, affiliated or otherwise, which write direct automobile insurance premium in Ontario, identify such companies.

The Board will also include these requirements in the Financial Reporting Package to be completed annually by each insurer as defined in the Act.

B. FUTURE REVIEW OF RATES

13.13 Ms. Bass testified with respect to frequency of rate review, and expressed the opinion that rates should be reviewed annually since more often would be "impractical" and "inappropriate" and less often would make pricing difficult. Ms. Bass stated that the

annual review should encompass both overall average rates and rate differentials. She pointed out that, in perhaps six years, the data on classification differentials would be of sufficient quality that an annual review of some or all differentials would not be required. However, the overall average rates would still require annual review (Transcript, at 3371-74).

13.14 Industry representatives agreed that a review of rates should be done annually. The Industry Coalition, Pafco and Dominion stated in their submissions that the Board should also monitor the market for changes in trends and distributions that would have an impact on assumptions made during the prior rate review. If changes are considered significant, the Board should hold more frequent hearings (Written Submission, at 20-21; Pafco, Final Argument, at 6; Dominion, Written Summary Arguments, at 4).

13.15 With respect to the timing of future rate reviews, Ms. Bass recommended using December 31 accident year data valued at 15 months (March 31). It would take approximately three months to aggregate, edit and correct this data. A rate proposal could be available in October and the Board could commence a rate hearing

in November, with an effective date of the rate change in March (Transcript, at 3373-74).

13.16 The Industry Coalition indicated that an appropriate time to implement rates would be May or June. Financial reporting information would be available to companies, which would allow them sufficient time to review and implement rates (Written Submission, at 21). State Farm recommended that a rate hearing commence in the summer of 1989 in order to have new rates effective January, 1990 (Argument, at 7).

13.17 The Submission of Board Counsel recommended an annual review of rates in September for a January 1 effective date (at 9/2).

Board Decision

13.18 The Board acknowledges that, at least until data of a quality sufficient for rate making is available under the Board Statistical Plan, an annual review of both the overall rates and the classification differentials will be necessary. The Board notes that it will be at least five years before data that can be relied upon for rate making purposes will be available.

- 13.19 The Mercer recommendation that accident year data valued at 15 months be used will require reporting by the industry on a quarterly basis. The Statistical Plan will reflect this requirement.
- 13.20 The Board will use 12 month data until data can be made available for valuation as of 15 months. Accordingly, the Board will require that the aggregation, editing and correction of data be completed by March 31, and that a proposal be available for publication in early August. The Board will schedule its rate hearing for September, to make possible an effective date for implementation of rates, if any, by January 1.
- 13.21 The Board will hold a rate hearing in September, 1989 to review the rates and ranges of rates set by the Board in this hearing.

C. CONSUMER INFORMATION

- 13.22 During the course of this Industry-Wide Hearing, the Board received comments and submissions from the general public concerning the inability of the average individual to comprehend the methods used to calculate the premiums charged. The hundreds of letters and

thousands of telephone calls that the Board has received during the course of this part of the Industry-Wide Hearing (I-88-1D) attest to the confusion, misunderstanding and mistrust that Ontario automobile insureds have concerning the justice and fairness of the present system. A more fulsome discussion of the public input in this hearing is found in Chapter 4.

13.23 The CAC has been an active participant in all parts of the Industry-Wide Hearing. In its Final Argument the CAC stated (at 2):

CAC believes that the Ontario Automobile Insurance Board has an important role to play in educating the driving public. The Board's attempts to encourage public participation in the Hearings suggest that it might be prepared to take a more active role than is usual for regulatory bodies in explaining its decisions to the public and in attempting to ensure that the public will benefit from its decisions... [T]hey [consumers] need information that will explain how premiums are calculated and they need a shopping guide to help them compare rates. Information is a critical component of competition.

13.24 This idea of a "consumer's shopping guide" was also raised by the CAC's expert witness, Mr. Hunter, in his pre-filed evidence (Exhibit 22.1, at 21). Mr. Hunter was challenged on this point during cross-examination

by Safeco. During this cross-examination, Mr. Hunter was asked (Harpur, Transcript, at 3486):

Might it be misleading if only price were publicized and not these other factors? [factors such as claims service, policy service, financial strength and stability].

Mr. Hunter responded, "As a consumer I love to be misled by knowing the price... And the idea that it [price] misleads people, to me, is nonsense; it helps people." (Transcript, at 3486).

13.25 The type of consumer information that the Board could make available was also discussed by Ms. Bass. In response to Mr. Baggaley's suggestion that the Board publish information that would "... set out where various companies had chosen to put themselves above and below the benchmark rate ...", Ms. Bass replied that she thought "rating samples" would be appropriate. People "are better off seeing some concrete examples, they can find ones that relate to them, and then they can go and shop and around to the various brokers and agents" (Transcript, at 3726).

Board Decision

13.26 The Board has determined that it can and will play a role in informing the people of Ontario about the

classification and rating of automobile insurance. In order for a competitive automobile insurance marketplace to operate, consumers need accurate information to help them determine the best levels of price and service available to meet their particular automobile insurance needs.

13.27 The Board acknowledges that one of the elements in setting rates that are just and reasonable and not excessive or inadequate is competition. Healthy competition, based on considerations of financial, administrative and operational efficiency, is beneficial to all the publics in this market place and is enhanced through the participation of informed consumers.

13.28 To further consumer understanding and market place competition, the Board will:

(a) Publish a Rates Manual

This manual will be for the use of consumers as well as insurance company personnel and insurance agents/brokers. The manual will contain a full description of the Board's rates, rules, definitions and classifications. The design committee for the

manual includes representatives from the CAC, the IBAO and the industry. The manual will have wide distribution through brokers, agents and in public places such as libraries across the Province. Every person will be entitled to have access to this manual, as it will be the basis for rating every individual irrespective of the company through which he/she is insured.

(b) Publish Consumer Information Brochures

Brochures will be published from time to time as guides for use by consumers. At least one will focus on an explanation of the Board Class Plan, how the automobile insurance industry is organized in Ontario (including the distribution of the insurance product by brokers, agents and direct writers), and the various cost components of the premiums charged.

(c) Advertise Rate Comparisons

Once insurers have filed the rates they intend to use, the Board will, after identifying certain classes of risk on a territory-by-territory basis, provide a comparison guide that will supplement the consumer brochures. The Board intends to discuss immediately

with the industry, IBAO and the CAC the form and frequency of the publication.

(d) Make Available the Board Library and Public Records

The Board is in the process of setting up a library in its offices at 5 Park Home Avenue, North York, Ontario. The library will be fully accessible to any consumer during office hours. In addition, the record of all proceedings is available for viewing in the public reading area of the Board's offices.

(e) Publish Ontario Automobile Insurance Financial Results

The Board will publish, annually, in a form yet to be determined, the financial results of the Ontario automobile insurance industry. This information will receive wide public circulation.

13.29 The foregoing is merely the start of the information program which the Board intends to pursue to ensure that the competitiveness of the marketplace is enhanced through informed consumers.

14. IMPACT ANALYSIS

14.1 In section 7 of the Mercer Proposal (Exhibit 5.1), Mercer presented a method by which to measure the changes indicated by the proposed rates relative to the current rates. Mercer described this method as follows (at 98):

The only meaningful means by which to accomplish this is to provide a representative sample of case studies, rate the risks according to the current classification and rating structures of the market place and rate them again, according to the proposed classification and rating structure proposed in this report.

14.2 The Mercer Proposal included 72 case studies of drivers and their automobiles based on complete risk classification descriptions (Exhibit 5.1, at 257-334). For comparison purposes, these risks were rated according to the current rate manuals of five of the largest automobile insurers in Ontario, as well as the Facility Association. As Mercer noted, only "a very approximate calculation of anticipated 'average' rates can be made" (Exhibit 5.1, at 98).

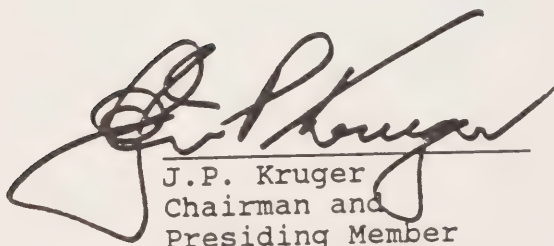
14.3 The Board has caused a new impact analysis to be completed incorporating the decisions made by the Board in this hearing. These case studies are presented in a

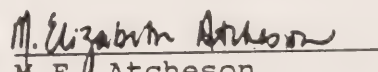
different format. Over one hundred cases have been summarized. The case studies are attached to this Decision as Appendix G.

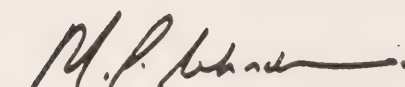
- 14.4 These cases are summarized in two sections. The first section (pages 1 to 11) shows, for an urban (Scarborough) territory and a rural (Timmins) territory, premium levels based on various classifications in the Board Class Plan. The second section (pages 12 to 16) shows premium levels for eight different territories based on a fixed set of classifications. Many cases in the second section parallel those originally included in the Mercer Proposal; these are cross-referenced.
- 14.5 In both sections, each page contains a description of the risk characteristics and the applicable coverages. Each page shows estimated premiums in today's market place, the Board-set rates based on the Board Class Plan, and the Board benchmark premiums. Also shown are the percentage impact of the Board Class Plan, the Board benchmark, and the top of the approved range.
- 14.6 In order to differentiate the impact of the Board Class Plan from the impact of the rate increases on the premiums paid by consumers, the Board estimated for

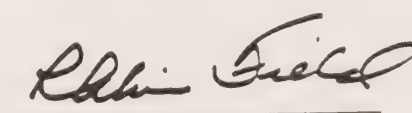
each case the current market premium and the premium that would be applicable if the Board Class Plan and the Board rate structure and rating factors were already in use. The market premiums were obtained by averaging the premiums of five of the largest automobile writers in Ontario. The Board Class Plan premiums are the results of dividing the Board benchmark premiums by the underlying overall rate increase. Further explanatory notes are provided at the bottom of each page.

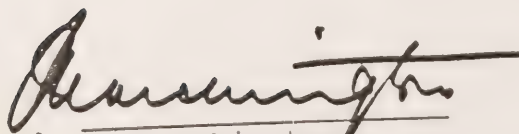
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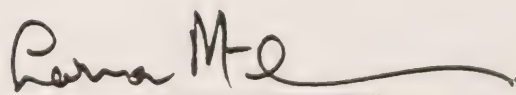

J.P. Kruger
Chairman and
Presiding Member


M.E. Atcheson
Vice Chair


M.P. Richardson
Vice Chair


A. Field
Member


F. Marchington
Member


L. Milne
Member

APPENDIX A

Table of Categories of Insurance and Classes of Risk Exposure

APPENDIX B

List of Insurers served with Notices and of
the newspapers in which Notice of Hearing and
Notice of Proposal were published

INSURANCE INDUSTRY

COMPANY NAME

ABSTAINER'S INSURANCE COMPANY
ADVOCATE GENERAL INSURANCE COMPANY OF CANADA
AETNA CASUALTY AND SURETY COMPANY, THE
AETNA INSURANCE COMPANY
ALGOMA MUTUAL FIRE INSURANCE COMPANY
ALLSTATE INSURANCE COMPANY OF CANADA
ALPINA INSURANCE COMPANY LIMITED
AMERICAN HOME ASSURANCE COMPANY
AMERICAN ROAD INSURANCE COMPANY, THE
ANGLO CANADA GENERAL INSURANCE COMPANY
AYR FARMERS' MUTUAL FIRE INSURANCE COMPANY, THE
BAY OF QUINTE AGRICULTURAL MUTUAL FIRE INSURANCE COMPANY
BERTIE AND CLINTON MUTUAL FIRE INSURANCE COMPANY
BLANSHARD MUTUAL INSURANCE COMPANY
BRAMT MUTUAL FIRE INSURANCE COMPANY
CAA INSURANCE COMPANY (ONTARIO)
CANADA ACCIDENT AND FIRE ASSURANCE COMPANY, THE
CANADA LIFE CASUALTY INSURANCE COMPANY
CANADIAN COMMERCE INSURANCE COMPANY, THE
CANADIAN GENERAL INSURANCE COMPANY
CANADIAN HOME ASSURANCE COMPANY
CANADIAN INDEMNITY COMPANY, THE
CANADIAN PROVINCIAL INSURANCE COMPANY, THE
CANADIAN SURETY COMPANY, THE
CASUALTY COMPANY OF CANADA, THE
CATUGA MUTUAL FIRE INSURANCE COMPANY
CENTURY INSURANCE COMPANY OF CANADA, THE
CHATEAU INSURANCE COMPANY
CHRYSLER INSURANCE COMPANY
CHUBB INSURANCE COMPANY OF CANADA
CIGNA INSURANCE COMPANY OF CANADA
CITADEL GENERAL ASSURANCE COMPANY, THE
CO-OPERATORS GENERAL INSURANCE COMPANY
COACHMAN INSURANCE COMPANY
COMMERCE AND INDUSTRY INSURANCE COMPANY OF CANADA
COMMERCIAL UNION ASSURANCE COMPANY OF CANADA
CONSTITUTION INSURANCE COMPANY OF CANADA
CONTINENTAL INSURANCE COMPANY OF CANADA, THE
CONTINENTAL INSURANCE COMPANY, THE
CONTINGENCY INSURANCE COMPANY LIMITED, THE
CORNHILL INSURANCE COMPANY OF CANADA
CURIS GENERAL INSURANCE COMPANY
DOMINION INSURANCE CORPORATION, THE
DOMINION OF CANADA GENERAL INSURANCE COMPANY, THE
DUFFERIN MUTUAL INSURANCE COMPANY
DUNFRIES MUTUAL INSURANCE COMPANY

EATON INSURANCE COMPANY
ECCLESIASTICAL INSURANCE OFFICE PUBLIC LIMITED COMPANY
ECONOMICAL MUTUAL INSURANCE COMPANY
ELMA MUTUAL FIRE INSURANCE COMPANY
EMPLOYERS INSURANCE COMPANY OF WAUSAU, A MUTUAL COMPANY
ERIE MUTUAL FIRE INSURANCE COMPANY
FARM MUTUAL REINSURANCE PLAN INC.
FARMERS' MUTUAL FIRE INSURANCE COMPANY (LINDSAY)
FEDERAL INSURANCE COMPANY
FEDERATED MUTUAL INSURANCE COMPANY
FEDERATION INSURANCE COMPANY OF CANADA
FIREMAN'S FUND INSURANCE COMPANY
FIRST NATIONAL INSURANCE COMPANY OF AMERICA
FORMOSA MUTUAL INSURANCE COMPANY
GAN INCENDIE ACCIDENTS COMPAGNIE FRANCAISE D'ASSURANCES
GENERAL ACCIDENT ASSURANCE COMPANY OF CANADA, THE
GENERAL INSURANCE COMPANY OF AMERICA
GIBRALTAR GENERAL INSURANCE COMPANY
GORE MUTUAL INSURANCE COMPANY
GRENVILLE PATRON MUTUAL FIRE INSURANCE COMPANY
GUARANTEE COMPANY OF NORTH AMERICA, THE
GUARDIAN INSURANCE COMPANY OF CANADA
HALIFAX INSURANCE COMPANY, THE
HAMILTON TOWNSHIP FARMERS' MUTUAL FIRE INSURANCE COMPANY, THE
HANOVER INSURANCE COMPANY, THE
HARTFORD INSURANCE COMPANY OF CANADA
HARTFORD INSURANCE COMPANY, THE
HAY TOWNSHIP FARMERS' MUTUAL FIRE INSURANCE COMPANY
HERALD INSURANCE COMPANY
HOME INSURANCE COMPANY, THE
HOWARD MUTUAL FIRE INSURANCE COMPANY
HOWICK MUTUAL INSURANCE COMPANY
INSURANCE COMPANY OF NORTH AMERICA
JEVCO INSURANCE COMPANY
KINGSWAY GENERAL INSURANCE COMPANY
LANBTON MUTUAL INSURANCE COMPANY
LANARK MUTUAL INSURANCE COMPANY
LAURENTIAN CASUALTY COMPANY OF CANADA
LAURENTIAN GENERAL INSURANCE COMPANY
LAURENTIAN SHIELD INSURANCE COMPANY, THE
LIBERTY MUTUAL FIRE INSURANCE COMPANY
LIBERTY MUTUAL INSURANCE COMPANY
LOBO MUTUAL FIRE INSURANCE COMPANY
LONDON TOWNSHIP MUTUAL INSURANCE COMPANY, THE
LOYALIST INSURANCE COMPANY, THE
LUMBERMENS MUTUAL CASUALTY COMPANY

COMPANY NAME

MAPLEX GENERAL INSURANCE COMPANY
MARKEL INSURANCE COMPANY OF CANADA
MCGILLIVRAY MUTUAL FIRE INSURANCE COMPANY
MCKILLOP MUTUAL INSURANCE COMPANY
METRO PUBLIC EDUCATION INSURANCE EXCHANGE
METROPOLITAN INSURANCE COMPANY
MISSISSAUGA AND ROUVILLE INSURANCE COMPANY, THE
MOTORS INSURANCE CORPORATION
NEW HAMPSHIRE INSURANCE COMPANY
NEW ROTTERDAM INSURANCE COMPANY
NIAGARA FIRE INSURANCE COMPANY
NON-MARINE UNDERWRITERS, THE, MEMBERS OF LLOYD'S, LONDON, ENGLAND
NORFOLK MUTUAL FIRE INSURANCE COMPANY
NORTH BLENHEIM MUTUAL INSURANCE COMPANY
NORTH KENT MUTUAL FIRE INSURANCE COMPANY
NORTHERN FRONTIER GENERAL INSURANCE COMPANY
OLD REPUBLIC INSURANCE COMPANY
ONTARIO SCHOOL BOARDS' INSURANCE EXCHANGE
OTTER DORCHESTER INSURANCE COMPANY LIMITED
OXFORD MUTUAL INSURANCE COMPANY
PACIFIC EMPLOYERS INSURANCE COMPANY
PAPCO INSURANCE COMPANY LIMITED
PEEL AND MARYBOROUGH MUTUAL FIRE INSURANCE COMPANY, THE
PEEL MUTUAL INSURANCE COMPANY
PERSONAL INSURANCE COMPANY OF CANADA, THE
PHOENIX ASSURANCE COMPANY OF CANADA
PHOENIX ASSURANCE COMPANY, LIMITED
PHOENIX INSURANCE COMPANY, THE
PILOT INSURANCE COMPANY
PORTAGE LA PRAIRIE MUTUAL INSURANCE COMPANY, THE
PRESCOTT MUTUAL FIRE INSURANCE COMPANY, THE
PROGRESSIVE CASUALTY INSURANCE COMPANY
PRUDENTIAL ASSURANCE COMPANY LIMITED, THE (OF ENGLAND)
PRUDENTIAL OF AMERICA GENERAL INSURANCE COMPANY (CANADA)
QUEBEC ASSURANCE COMPANY
ROYAL INSURANCE COMPANY OF CANADA
SAFECO INSURANCE COMPANY OF AMERICA
SCOTTISH AND YORK INSURANCE CO. LIMITED
SECURITY NATIONAL INSURANCE COMPANY
SENTRY INSURANCE, A MUTUAL COMPANY
SIMCOE & ERIE GENERAL INSURANCE COMPANY
SOUTH EASTHOPE FARMERS' MUTUAL INSURANCE COMPANY
SOVEREIGN GENERAL INSURANCE COMPANY, THE
ST. PAUL FIRE AND MARINE INSURANCE COMPANY
STANSTEAD & SHERBROOKE INSURANCE COMPANY, THE
STATE FARM FIRE AND CASUALTY COMPANY

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY
SUN ALLIANCE INSURANCE COMPANY
TOKIO MARINE AND FIRE INSURANCE COMPANY LIMITED, THE
TORONTO GENERAL INSURANCE COMPANY
TOWNSEND FARMERS' MUTUAL FIRE INSURANCE COMPANY
TRADERS GENERAL INSURANCE COMPANY
TRAFALGAR INSURANCE COMPANY OF CANADA
TRANSIT INSURANCE COMPANY
TRAVELERS INDEMNITY COMPANY OF CANADA
TRAVELERS INDEMNITY COMPANY, THE
UNIFUND ASSURANCE COMPANY
UNITED PROVINCES INSURANCE COMPANY, THE
UNITED STATES FIRE INSURANCE COMPANY
USF&G INSURANCE COMPANY OF CANADA
UTICA MUTUAL INSURANCE COMPANY
VICTORIA INSURANCE COMPANY OF CANADA
WABISA MUTUAL FIRE INSURANCE COMPANY
WATERLOO INSURANCE COMPANY
WAWANESA MUTUAL INSURANCE COMPANY, THE
WELLINGTON INSURANCE COMPANY
WEST ELGIN MUTUAL FIRE INSURANCE COMPANY
WEST WAWANOSH MUTUAL INSURANCE COMPANY, THE
WESTERN ASSURANCE COMPANY
WESTMINSTER MUTUAL FIRE INSURANCE COMPANY, THE
YASUDA FIRE AND MARINE INSURANCE COMPANY, LIMITED
YORK FIRE & CASUALTY INSURANCE COMPANY
ZURICH INSURANCE COMPANY

LIST OF NEWSPAPERS IN WHICH NOTICE OF HEARING
DATED NOVEMBER 14, 1988 WAS PUBLISHED

The Sudbury Star

Le Droit

The Ottawa Citizen

The Globe and Mail

The Toronto Star

The Toronto Sun

The London Free Press

The Thunder Bay Times-New/Chronicle-Journal

Toronto L'Express

Sudbury Le Voyageur

Windsor Le Rampart

LIST OF NEWSPAPERS IN WHICH
NOTICE OF PROPOSAL WAS PUBLISHED

Cornwall Le Journal-Opscom	Chesterville Record
Hawkesbury Le Carillon-Opscom	Colborne Chronicle
Hearst Le Nord-Opscom	Caledonia Grand River Sachem
Mississauga Horizon Sud	Cochrane Northland Post
L'Express d'Orleans-Opscom	Collingwood Enterprise-Bulletin
Le Courrier d'Oshawa	Creemore Star
Le Nord de Kapuskasing	Deep River North Renfrew Times
L'Edition Prescott Russell-Opscom	Delhi News-Record
Sturgeon Falls Tribune	Dundalk Herald
Sudbury Le Voyageur-Opscom	Dunnville Chronicle
Toronto L'Express	Dorchester Sign Post
Vanier Le Journal-Opscom	Drayton Community News
Windsor Le Rempart-Opscom	Dresden North Kent Leader
Alexandria Glengarry News	Dryden Observer
Alliston Herald	Durham Chronicle
Aylmer Express	Dutton Advance
Almonte Gazette	Dowling Onaping Falls News
Amherstburg Echo	Eganville Leader
Arnprior Chronicle Guide	Elliot Lake Standard
Arthur Enterprise News	Elliot Lake Tabloidy
Atikokan Progress	Elmira Independent
Ayr News	Elmvale Lance/Wasaga Times
Bancroft Times	Erin Advocate
Barry's Bay this Week (Madawasks Valley)	Espanola Mid-North Monitor
Beeton Innisfil Scope	Exeter Times-Advocate
Beeton Record Sentinel/Tottenham Times	Fenelon Falls Gazette
Belleville Quinte Weekly News	Fenelon Falls North Kawartha Times
Blenheim News-Tribune	Flesherton Advance
Blyth Citizen	Forest Standard
Bowmanville Canadian Statesman	Frankford Advertiser
Bobcaygeon Independent	Fergus-Elora News Express
Bothwell Times	Fergus-Wellington Advertiser
Bracebridge Examiner	Gananoque Reporter
Bracebridge Herald-Gazette	Georgetown Halton Hills Herald
Bracebridge Muskoka Advance	Geraldton Times-Star
Brighton Independent	Glencoe Alvinston Transcript & Free Press
Burks Falls/Powassan Almaguin News	Goderich Signal Star Group
Beaver Express/Cannington Gleaner	Gore Bay Manitoulin Recorder
Caledon Citizen	Gravenhurst Banner
Carleton Place Canadian	Gravenhurst News
Cayuga Regional News This Week	Grand Valley Star & Vidette
Cobden Sun	Hagersville Haldimand Press
Campbellford Courier	Havelock Citizen
Campbellford Herald	Harriston Review
Rainbow Report	Hastings Star
Chesley Enterprise	Hawkesbury Express
Chapleau Sentinel	Haliburton County Echo & Minden Recorder

Hanover Post	Paisley Advocate
Hornepayne Bear News	Palmerston Observer
Harrow News	St. George Lance
Harrow This Week	Paris This Week
Huntsville Forester	Picton Gazette
Huntsville Herald News	Port Dover Maple Leaf
Ignace Driftwood	Greater Pembroke Enterprise
Ingersoll Times	Perth Courier
Iroquois Falls Enterprise	Cobourg Independent
Iroquois Chieftan	Port Perry Star
Kanata Kourier	Parkhill Gazette
Kanata Standard	Prescott Journal
Kapuskasing Northern Times	Parry Sound Beacon Star
Kemptville Advance	Parry Sound North Star
Keswick Georgina Advocate	Port Elgin Beacon-Times
Kingston Amherstview Heritage	Petrolia Advertiser-Topic
Kincardine Independent	Rainy River Record
Kingsville Reporter	Red Lake District News
Leamington Post & News	Renfrew Mercury
Longlac Northern Star	Ridgetown Dominion
Listowel Banner	Rodney Mercury
Lambeth News Star	Sarnia Gazette
Lanark New Era	Smith Falls Record-News
Little Current Manitoulin Expositor	Strathroy Age Dispatch
Madoc Review	Stirling Community Press
Midland/Penetanguishene Free Press	Stirling New Argus
Midland Times/Pentanguishene	St. Mary's Journal Argus
Citizen	Highland Herald
Meaford Express	Stittsville News
Mildmay Town & Country Crier	Stayner Sun
Minden Times	Tara Leader
Mount Albert/East Gwillimbury	Tavistock Gazette
Communicator	Teeswater News
Mount Forest Confederate	Thamesville Herald
Morrisburg Leader	Thessalon North Shore Sentinel
Markdale Standard	Thornbury Courier Herald
Marmora Herald	Tillsonburg News
Marathon Mercury	Timmins Freighter
Manotick Messenger	Tilbury Times
Mattawa Recorder	Terrace Bay Schreiber News
Manitouwadge Echo	Trenton Trentonian & Tri-County
Milverton Sun	News
Napanee Beaver	Tweed News
Nanticoke Times	Uxbridge Times Journal
Nipigon Gazette	Vankleek Hill Review
Norwood Register	Wallaceburg Courier-Press
Norwich Gazette	Wallaceburg News
Newcastle Independent	Warkworth Journal
New Hamburg Independent	Wawa Algoma News Review
New Liskeard Temiskaming Speaker	Winchester Press
Orangeville Banner	Wheatley Journal
Orangeville Citizen/Shelburne Free	Wiarton Echo
Press & Econ.	Wingham Advance Times
Orono Weekly Times	Westport and Rideau Valley Mirror

Watford Guide-Advocate
West Lorne Sun
Zurich Advance
Agincourt News
Ancaster News Journal
Belle River North Essex News
Brantford Brant News
Fairway Group Inc.
Dundas Ancaster Recorder
Dundas Star Journal
Essex Free Press
Etobicoke Life
Fonthill Pelham Herald
Fort Francis Times
Grimsby Independent Group
Hamilton Journal West
Hamilton Mountain News
Hamilton Recorder
King City Vaughan Weekly
Kingston This Week
Lindsay Thursday Post
Milton Observer
Newmarket Metro North News
North York News
Orillia Sun
Ottawa Centretown News
Ottawa Nepean Clarion
Paris Star
Port Colborne News
Pembroke Advertiser News
Pickering's Bay News
Pickering Post
Scarborough News
Stoney Creek News
Sioux Lookout Northwest Explorer
Sudbury Northern Life
Thunder Bay Lakehead Living
Cabbagetown-Riverdale News
Toronto East End Express
Toronto East End News
Wright Media Limited
Thorold News
Whitby Free Press
Toronto West Hill News
Welland Guardian Express
Metroland Ltd.
Waterdown Flamborough News
Waterdown Flamborough Review
Barrie Examiner
Belleville Intelligencer
Brantford Expositor
Brampton Daily Times
Cambridge Daily Reporter
Chatham Daily News

Cobourg Daily Star
Cornwall Standard-Freeholder
Fort Frances Daily Bulletin
Guelph Mercury
Hamilton Spectator
Kingston Whig-Standard
Kirkland Lake Northern Daily News
Kitchener-Waterloo Record
Kenora Miner & News
Lindsay Daily Post
London Free Press
North Bay Nugget
Niagara Falls Review
Orillia Packet & Times
Oshawa Times
Ottawa Citizen
Ottawa Sun
Owen Sound Sun Times
Pembroke Observer
Peterborough Examiner
Port Hope Guide
Sarnia Observer
Simcoe Reformer
Sault Ste. Marie Star
St. Catharines Standard
St. Thomas Times Journal
Stratford Beacon-Herald
Sudbury Star
Thunder Bay Times-News/Chronicle-
Journal
Timmins Press
Toronto Globe and Mail - Ontario
Edition
Toronto Star
Toronto Sun
Welland/Port Colborne Tribune
Windsor Star
Woodstock Daily Sentinel Review

APPENDIX C

Notice I-88-1A,B,C,D, Notice I-88-1D,
Notice of Proposal, Procedural Order -1,
Procedural Order -2



Office of the
Chairman
Bureau du
Président

Ontario
Automobile
Insurance
Board

Commission de
L'Assurance-
Automobile
de L'Ontario

2nd Floor
543 Yonge Street
Toronto, Ontario
M7A 2H6
963-3460

2^e étage
543, rue Yonge
Toronto (Ontario)
M7A 2H6
963-3460

File No: I-88-1A,B,C,D

NOTICE INDUSTRY-WIDE HEARING

THE ONTARIO AUTOMOBILE INSURANCE BOARD (the "Board"), on its own motion, will hold an Industry-Wide Hearing pursuant to section 20 of the Ontario Automobile Insurance Board Act, 1988, R.S.O. 1988, c.18. The Board is holding a hearing to set a rate or range of rates with respect to each class of risk exposure prescribed by Ontario Regulation 406/88 (the "classification system").

The Industry-Wide Hearing has been separated into four parts:

1. The hearing on the classification system and data availability to be used to set industry-wide rates and rate ranges effective January 1, 1989 will commence on Wednesday, August 10, 1988 at 9 o'clock a.m. at 2300 Yonge Street, 25th Floor, Toronto, under Board File No. I-88-1A.
2. The hearing on rate-making methodology will commence on Monday, August 22, 1988 at 9 o'clock a.m. at North York Memorial Community Hall, 5110 Yonge Street, North York, under Board File No. I-88-1B.
3. The hearing on profitability standards will commence on Monday, August 22, 1988 at 9 o'clock a.m. at North York Memorial Community Hall, 5110 Yonge Street, North York, under Board File No. I-88-1C.
4. The hearing on the proposed rates or range of rates, effective January 1, 1989, will commence following the conclusions of the hearings and the issuing of the decisions on the above three parts, at a time and date to be appointed by the Board, under Board File No. I-88-1D.

A PRE-HEARING CONFERENCE will be held on Wednesday, July 27, 1988, at 9:00 a.m., in the Ontario Room, Macdonald Block, Queen's Park, Toronto to deal with preliminary matters, including, but not limited to the following:

- o written evidence to be pre-filed
- o the interrogatory process
- o the hearing process
- o issues

IF YOU WISH TO PARTICIPATE AS A PARTY IN ANY PART OF THE HEARING, you (or your lawyer or agent) must file with the Board a written notice of your intention to participate as a party with the Board on or before MONDAY, JULY 25, 1988. A person who files such a notice intends to fully participate in the hearing.

INSTEAD OF PARTICIPATING AS A PARTY IN THE HEARING, you may comment on any of the issues as a LIMITED INTERVENOR by filing a letter of comment with the Board. A letter of comment should clearly state your views, set the grounds and the factual basis for your position, and indicate whether you intend to make an oral presentation to the Board. Letters of comment should be filed at the Board Office before the commencement of the hearing in which you are interested.

PROCEDURAL ORDERS as to how the matter will proceed may be issued from time to time. Copies of any procedural orders will be sent to all persons filing a notice of intention to participate. The Board has issued Procedural Order - 1 on July 6, 1988.

Manuals describing the practice, procedures and rules to be used by the Board are available free of charge from the Board Office and may be picked up during office hours Monday to Friday, 8:30 a.m. to 4:45 p.m. You may also examine all documents filed in these proceedings during office hours.

IF YOU DO NOT BECOME A PARTY TO THE HEARING OR INDICATE THAT YOU WISH TO MAKE AN ORAL PRESENTATION TO THE BOARD, THE BOARD MAY PROCEED IN YOUR ABSENCE AND YOU WILL NOT BE ENTITLED TO ANY FURTHER NOTICE OF THESE PROCEEDINGS.

DATED AT TORONTO THIS 6th DAY OF JULY, 1988.

S. Coroyannakis

ONTARIO AUTOMOBILE
INSURANCE BOARD
543 Yonge Street
2nd Floor
Toronto, Ontario
M7A 2H6
Phone No. (416) 963-3460
Fax No. (416) 965-8942
Collect telephone calls
accepted.

Attn: Sophia Coroyannakis
Board Secretary



Ontario Commission de
Automobile l'assurance-
Insurance automobile
Board de l'Ontario

File No. I-88-1D

IN THE MATTER OF the Ontario Automobile
Insurance Board Act, 1988, S.O. 1988, c. 18;

AND IN THE MATTER OF an industry-wide hearing
by the Ontario Automobile Insurance Board
pursuant to section 20 of the said Act.

NOTICE OF HEARING
INDUSTRY-WIDE HEARING

THE ONTARIO AUTOMOBILE INSURANCE BOARD (the "Board") will commence the fourth part of its Industry-Wide Hearing, under File No. I-88-1D, on Monday, December 12, 1988 at 9 o'clock a.m. in the Board's Hearing Room, 2nd Floor, 5 Park Home Avenue, North York.

The purpose of this hearing is to set rates or ranges of rates for the classes of risk exposure set out in the Board's Decisions under File No. I-88-1A (the "Board Class Plan").

William M. Mercer Limited was engaged by the Board to produce proposed rates or ranges of rates (the "Proposal"). William M. Mercer Limited is independent of the Board and of the insurance industry. The purpose of publishing proposed rates in the form of a proposal is to assist both the Board and the public by providing one context for the hearing. The Proposal is not binding on the Board. The Proposal will be released in two parts. The first part, available to any person upon request after December 5, 1988, will be restricted to proposed rates for Personal Vehicles - Private Passenger Automobile. The second part, available to any person upon request on January 23, 1989, will deal with proposed rates for all other categories of insurance identified in the Board Class Plan.

A PRE-HEARING CONFERENCE will be held on Wednesday, December 7, 1988 at 9 o'clock a.m. in the Board's Hearing Room to deal with preliminary matters, including, but not limited to the following:

- o written evidence to be pre-filed
- o the interrogatory process
- o the hearing process
- o issues

IF YOU WISH TO PARTICIPATE AS A PARTY IN THE HEARING, you (or your lawyer or agent) must file with the Board a written notice of your intention to participate as a party with the Board on or before **Tuesday, December 6, 1988**. A person who files such a notice intends to fully participate in the hearing. If you have already filed your notice of intention to participate in response to the Notice dated July 6, 1988, it is not necessary to file a further notice.

INSTEAD OF PARTICIPATING AS A PARTY IN THE HEARING, you may comment on any of the issues as a LIMITED INTERVENOR by filing a letter of comment with the Board. A letter of comment should clearly state your views, set the grounds and the factual basis for your position, and indicate whether you intend to make an oral presentation to the Board. Letters of comment on Part 1 of the Proposal - Private Passenger Automobile must be filed at the Board's office on or before **Monday, December 19, 1988**. Letters of comment on Part 2 of the Proposal must be filed on or before **Monday, February 6, 1989**.

ALL DOCUMENTS FILED IN THIS PROCEEDING are available for viewing at the Board's office during office hours Monday to Friday, 8:30 a.m. to 4:45 p.m.

PROCEDURAL ORDERS as to how the matter will proceed may be issued from time to time. Copies of any procedural orders will be sent to all persons filing a notice of intention to participate.

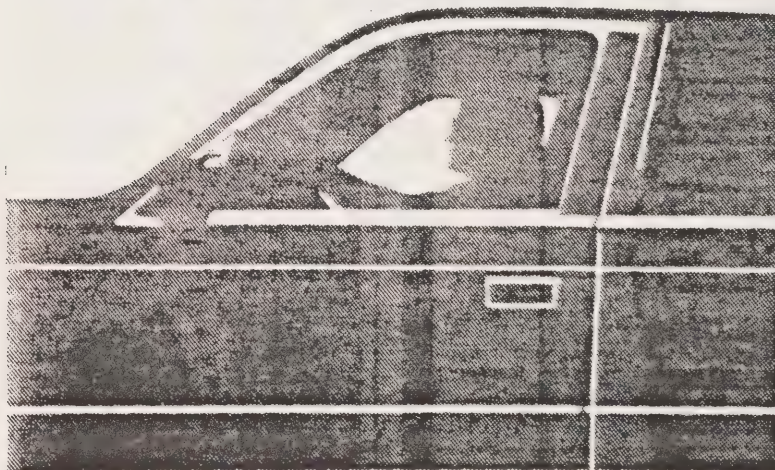
IF YOU DO NOT BECOME A PARTY TO THE HEARING OR INDICATE THAT YOU WISH TO MAKE AN ORAL PRESENTATION TO THE BOARD, THE BOARD MAY PROCEED IN YOUR ABSENCE AND YOU WILL NOT BE ENTITLED TO ANY FURTHER NOTICE OF THESE PROCEEDINGS.

DATED AT NORTH YORK THIS 14th DAY OF NOVEMBER, 1988.

Sophia Coroyannakis
Board Secretary
ONTARIO AUTOMOBILE INSURANCE BOARD
4th Floor, 5 Park Home Avenue
North York, Ontario
M2N 6L4
Phone No. (416) 222-2886
Fax No. (416) 222-4467
Collect telephone calls accepted

Cet avis est disponible en version française.

AUTO INSURANCE RATES PROPOSAL



PUBLIC HEARING

The Auto Board will commence a Public Hearing beginning December 12, 1988 to consider Auto Insurance Rates to be effective in 1989.

Independent consultants have now issued their proposal for these rates. Copies are available.

The Board is not bound by this proposal. Public participation in the hearings is essential. You have the right to be heard. Exercise it!

For further information call:

Toronto: 222-AUTO

Toll free: 1-800-668-0128



Ontario

Ontario
Automobile
Insurance
Board

Commission de
l'assurance-
automobile
de l'Ontario

5 Park Home Avenue
4th Floor
North York, Ontario
M2N 6L4

Cet avis est disponible en version française



File Nos. I-88-1A,B,C,D

IN THE MATTER OF the Ontario Automobile
Insurance Board Act, 1988, S.O. 1988, c.18;

AND IN THE MATTER OF an industry-wide hearing
by the Ontario Automobile Insurance Board
pursuant to Section 20 of the said Act.

BEFORE: John P. Kruger, Chairman)
Mary Elizabeth Atcheson, Vice-Chair)
M. Patricia Richardson, Vice-Chair)
Samuel Eckler, Member)
Alvin Field, Member) July 5, 1988
Frank Marchington, Member)
Laurel I. Martin, Member)
Lorna Ann Milne, Member)
Bhagwant N. Persaud, Member)
Gilles Racicot, Member)

Procedural Order - 1

UPON the Ontario Automobile Insurance Board (the "Board")
having issued a Notice dated July 6, 1988 calling, on its own
motion, an Industry-Wide Hearing;

AND WHEREAS the Board has separated the Industry-Wide
Hearing into four parts:

- o the classification system and data availability
(File No. I-88-1A)
- o rate-making methodology (File No. I-88-1B)
- o profitability standards (File No. I-88-1C)
- o the proposed rates or ranges of rates effective
January 1, 1989 (File No. I-88-1D);

AND WHEREAS the Notice sets out the times and places for the four hearings to be held within the Industry-Wide Hearing;

AND WHEREAS the Board is of the opinion that it is necessary at this time to make procedural provisions for the Industry-Wide Hearing;

IT IS ORDERED THAT:

Pre-filing

1. A list of parties will be prepared by the Board Secretary and provided on or before Tuesday, July 26, 1988 to those persons who have indicated their intention to participate as parties (in accordance with the Notice) in all or part of the proceeding (the "Parties").
2. (a) The following will be provided to Parties (as they become known):
 - (i) General Procedures Manual
 - (ii) Draft Rules of Practice and Procedure for Hearings commencing August 1988.
- (b) The following material will be provided to Parties (as they become known) upon request:
 - (i) DMR/Mercer Report, Recommendations and Issues concerning Data Capture, Data Quality, Database and Systems Requirements for the proposed Class Plan and Rate-making method
 - (ii) Ontario Regulation 406/88 made under the Ontario Automobile Insurance Board Act, 1988-Classification System
 - (iii) Mercer Study, Rate-making Methodologies Ontario Automobile Insurance
 - (iv) Testimony of Basil A. Kalymon/Coopers & Lybrand on the Financial Structure, Cost of Capital and Underwriting Margins of the Ontario Automobile Insurance Industry
 - (v) Update on DMR/Mercer Report
 - (vi) Update on Mercer Study

- (vii) Other material which is appropriate to be considered at the hearings.

Pre-Hearing Conference

- 3. A preliminary issues list, to be discussed at the Pre-hearing Conference on July 27, 1988, will be provided to all Parties on or before July 26, 1988.

Hearing - File No. I-88-1A

- 4. (a) Subject to paragraph 5, Parties who wish to submit written evidence on the classification system and data availability shall do so by filing it with the Board on or before Wednesday, August 3, 1988.
 - (b) The written evidence filed under paragraph 4(a) may include comments on the DMR/Mercer Report.
- 5. (a) Comments submitted in response to A Classification System for Automobile Insurance: A Draft for consultation, dated February 1988 (the "Consultation Draft") will be accepted as evidence at the hearing.
 - (b) Parties who submitted comments on the Consultation Draft and who wish to adopt those comments as their evidence may do so by filing with the Board a notice to that effect, in addition to any other written evidence they wish to file.

Hearing - File No. I-88-1B

- 6. (a) Parties who wish to ask interrogatories on the Mercer Study (rate-making methodology) shall do so by written interrogatories filed with the Board on or before Tuesday, August 2, 1988.
 - (b) Responses to said interrogatories shall be provided on or before Tuesday, August 9, 1988.
- 7. Parties who wish to submit written evidence on rate-making methodology shall do so by filing it with the Board and providing a copy to Parties, who requested the written evidence, on or before Friday, August 5, 1988.

8. (a) Board Counsel and Parties who wish to ask interrogatories on the written evidence filed under paragraph 7 shall do so by written interrogatories filed with the Board and provided to the relevant party on or before Friday, August 12, 1988.
- (b) Responses to said interrogatories should be filed with the Board and provided to all Parties who requested the written evidence on or before Friday, August 19, 1988.

Hearing - File No. I-88-1C

9. (a) Parties who wish to ask interrogatories on the Kalymon/Coopers & Lybrand testimony (profitability standards) shall do so by written interrogatories filed with the Board on or before Tuesday, August 2, 1988.
- (b) Responses to said interrogatories shall be filed with the Board and provided to all Parties, who requested the written evidence, on or before Tuesday, August 9, 1988.
10. Parties who wish to submit written evidence on profitability standards shall do so by filing it with the Board and delivering a copy to Parties, who requested the written evidence, on or before Friday, August 5, 1988.
11. (a) Board Counsel and Parties who wish to ask interrogatories on the written evidence filed under paragraph 10 shall do so by written interrogatories filed with the Board and provided to the relevant party on or before Friday, August 12, 1988.
- (b) Responses to said interrogatories shall be filed with the Board and provided to all Parties, who requested the written evidence, on or before Friday, August 19, 1988.

Hearing - File No. I-88-1D

12. A procedural order will issue dealing with this hearing.

Limited Intervenors

13. (a) Limited Intervenors shall submit their letters of comment before the commencement of the relevant hearing.
- (b) A Limited Intervenor who wishes to make an oral presentation to the Board shall indicate that intention in the letter of comment.

Costs - S. 16 of the Act

14. The issue of costs is to be addressed in the Industry-Wide Hearing and submissions on costs will be requested.

ISSUED AT TORONTO this 6th day of July, 1988.

S. Coroyannakis

Sophia Coroyannakis
Board Secretary

Ontario Automobile Insurance Board
543 Yonge Street, 2nd Floor
Toronto, Ontario
M7A 2H6

Phone No. (416) 963-3460

Fax No. (416) 965-8942

Collect telephone calls accepted



Ontario
Automobile
Insurance
Board

Commission de
l'assurance-
automobile
de l'Ontario

5 Park Home Avenue
4th Floor
North York, Ontario
M2N 6L4
(416) 222-2886

5, avenue Park Home
4^e étage
North York (Ontario)
M2N 6L4
(416) 222-2886

File No. I-88-1D

IN THE MATTER OF the Ontario Automobile
Insurance Board Act, S.O. 1988, c.18;

AND IN THE MATTER OF an industry-wide hearing
by the Ontario Automobile Insurance Board
pursuant to Section 20 of the said Act.

BEFORE: John P. Kruger, Chairman)
Mary Elizabeth Atcheson, Vice-Chair)
M. Patricia Richardson, Vice-Chair) December 7, 1988
Alvin Field, Member)
Frank Marchington, Member)
Lorna Ann Milne, Member)

Procedural Order - 2

UPON the Ontario Automobile Insurance Board (the "Board")
having issued a Notice dated July 6, 1988 calling, on its own
motion, an Industry-Wide Hearing;

AND WHEREAS the Board issued a Notice dated November 14,
1988 setting out the times and place for the part of the
Industry-Wide Hearing on the proposed rates or ranges of rates
(the "Hearing");

AND WHEREAS the Board issued Procedural Order - 1 dated July
6, 1988, which provided that a procedural order for the Hearing
to deal with procedural matters would be made in due course;

AND UPON the Board having held the Pre-Hearing Conference on
December 7, 1988 in which, amongst other matters, issues for the
Hearing were discussed;

AND WHEREAS the Board is of the opinion that it is necessary
at this time to make procedural provisions for the Hearing and
that it would be expedient to develop a list of issues to provide
direction to the parties;

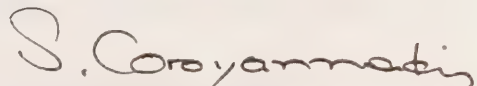
IT IS ORDERED THAT:

1. (a) Parties who wish to ask interrogatories on the Insurance Rate Proposal for Ontario Private Passenger Automobile, prepared by William M. Mercer Limited, dated December 5, 1988 (the "Mercer Proposal") may do so by written interrogatories filed with the Board on or before Friday, December 9, 1988.

(b) Responses to said interrogatories may either be provided to the parties who requested the written evidence before the commencement of the hearing on Monday, December 12, 1988, or may be given orally, in examination-in-chief, by the appropriate witness at the Hearing.
2. Parties who wish to submit written evidence shall do so by filing it with the Board and delivering a copy to the parties who requested the written evidence, at least three days before their witness is scheduled to testify at the Hearing.
3. (a) The list of issues, attached as Schedule "A" to this Order, are the issues which parties should address in the hearing under File I-88-1D in the Industry-Wide Hearing.

(b) If a party wishes to add a further issue, the party should make a motion to the Board further to Rule 8 of the Draft Rules of Practice and Procedure for Hearings commencing August 1988.

ISSUED AT TORONTO this 7th day of December, 1988.



S. Coroyannakis
Board Secretary

Ontario Automobile Insurance Board
5 Park Home Avenue, 4th Floor
North York, Ontario
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Phone No. (416) 222-2886
Fax No. (416) 222-4467

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Schedule 'A'
To Procedural Order-2
dated December 7, 1988
Under File No. I-88-1D

S. Coroyannakis
S. Coroyannakis
Board Secretary

ISSUES LIST

PROPOSED RATES OR RANGES OF RATES

FILE NO. I-88-1D

ISSUE 1: ARE THE PROPOSED RATES OR RANGES OF RATES JUST AND REASONABLE AND NOT EXCESSIVE OR INADEQUATE?

- (a) How have pricing decisions been made historically at the company level?
- (b) What effect, if any, do historic pricing decisions have on the Mercer Proposal?
- (c) Are the classification differentials proposed in the Mercer Proposal appropriate?

ISSUE 2: IS THE RATE MAKING METHODOLOGY UTILIZED IN THE MERCER PROPOSAL APPROPRIATE IN LIGHT OF THE PREVIOUS BOARD'S DECISIONS AND THE AVAILABILITY AND RELIABILITY OF DATA?

- (a) In those instances where actuarial judgment is utilized, was it applied appropriately?
- (b) Can evidence be adduced to support the inclusion in the rate making methodology of an explicit systematic bias provision?

ISSUE 3: HOW SHOULD RATE RANGES, WHERE APPROPRIATE, BE ESTABLISHED?

- (a) Should rate ranges be structured as suggested in Exhibit 5.14, filed in the hearing I-88-1B, in any of the following ways:
- establishment of ranges on loss costs and expense costs
 - application of ranges to line and coverage
 - establishment of the range symmetrically or asymmetrically around a benchmark rate
 - application of the range to base rates only
 - application of the same range to all classification cells
 - application of different ranges to different groups of classification cells
- (b) What should be the width of the ranges?
- (c) What considerations are relevant to the establishment of an appropriate width (refer to Exhibit 5.14, filed in the hearing I-88-1B)?
- (d) In what circumstances, if any, would a single rate as opposed to a range of rates be appropriate?

ISSUE 4: HOW REASONABLE IS THE DATA UPON WHICH THE RATES/
RANGES OF RATES HAVE BEEN DETERMINED?

- (a) Is the data, upon which the overall rates are established, reliable?
- (b) Is the data, upon which the classification differentials are established, reliable?

ISSUE 5: SHOULD RATE DIFFERENTIALS BE ESTABLISHED BETWEEN THE
FACILITY ASSOCIATION AND THE VOLUNTARY MARKET?

- (a) If so, how?
- (b) If not, why not?

ISSUE 6: SHOULD A MAXIMUM TRANSITIONAL RATE CHANGE TO ANY
INDIVIDUAL INSURED BE SET?

- (a) If so,
 - (i) how,
 - (ii) at what level, and
 - (iii) over what time period?

ISSUE 7: IS THE GENERALIZED UNIFORM RATE MAKING ALGORITHM
PROPOSED BY THE TECHNICAL COMMITTEE ESTABLISHED BY THE
BOARD IN I-88-1B APPROPRIATE?

- (a) How should the generalized uniform rate making algorithm be parameterized?

ISSUE 8: SHOULD AN APPLICANT BE REQUIRED TO FILE COMPANY GROUP
INFORMATION AS PART OF ITS DEVIATION INFORMATION
REQUEST?

ISSUE 9: SHOULD THE BOARD ESTABLISH A POLICY FOR THE REGULAR
REVIEW OF RATES/RANGES OF RATES?

ISSUE 10: DO THE VEHICLE RATE GROUPS PROPOSED BY THE VEHICLE CODE SERVICE COMPLY WITH THE DECISIONS OF THE BOARD MADE TO DATE AND IS THE DATA APPROPRIATE FOR INCLUSION IN THE RATE PROPOSAL FOR 1989 RATES?

- (a) Are the rate group relativities appropriate?
- (b) Is the rate group drift appropriately included in the rate making process when vehicle rate group relativities are established?

ISSUE 11: ARE CHANGES OR CLARIFICATIONS NECESSARY TO THE BOARD
CLASS PLAN BECAUSE OF THE MERCER PROPOSAL, OR ANY OTHER
RATE PROPOSAL ACCEPTED BY THE BOARD?

- (a) Should the Board Class Plan be changed to reflect a forgiveness period of three years for chargeable convictions, and not two years as previously determined by the Board in its Decision I-88-1A (see the Mercer Proposal at page 52)? If so, should the forgiveness of two minor convictions be changed?

APPENDIX D

List of Parties who appeared, the Limited
Intervenors, the Witnesses and of Petitions Filed

PARTY	REPRESENTATIVE	WITNESS
Progressive Casualty Insurance Company (Progressive)	A.Rogacki General Manager and Chief Agent for Canada G.Quon President Manager	A.Rogacki C.Ford Corporate Chief Actuary
Safeco Insurance Companies (Safeco)	M.Harpur	D.Harper Accounting Manager A.Hanks Regional Manager, Personal Lines Canada G.Bellinghausen Chief Actuarial Officer J.McArthur Resident Vice President Canada
State Farm Insurance Companies (State Farm)	H.Brown	F.Fraser Vice President Canada S.Lehmann Senior Actuary B.MacGregor Accounting Manager
Kingsway General Insurance Company (Kingsway)	W.Star President and General Manager	W.Star
William M. Mercer Limited (Mercer)	R.Stephenson	
New Democratic Party Caucus (NDP)	B.Rae Leader P.Kormos, MPP Welland-Thorold J.Mundy Research Assistant	
Pafco Insurance Company (Pafco)	J.Dean E.Belton Vice Chairman and Chief Executive Officer	E.Belton J.Cheng Actuary, Eckler Partners Limited J.Emo Vice President D.McIntyre President

PARTY	REPRESENTATIVE	WITNESS
Association of Canadian Insurers (ACI)	H.Kay President	
Commercial Union Assurance Company of Canada (Commercial Union)	V.Taht Vice President and Casualty Actuary	
Consumers' Association of Canada (Ontario) (CAC)	C.Baggaley CAC Staff	J.Hunter Actuary
The Dominion of Canada Group (The Dominion)	W.O'Connor J.Christie Vice President and Chief Actuary	J.Christie J.Clark Vice President of Finance J.Waugh President and Chief Executive Officer
"Industry Coalition" Insurance Bureau of Canada (IBC), The Association of Canadian Insurers (ACI), Ontario Mutual Insurance Association, Insurers' Advisory Organization (IAO), Certain independent non-aligned insurers	J.Howard, Q.C. N.Finkelstein J.Galway	S.Chan Manger of Actuarial and Quality Control Service R.Miller Consulting Actuary, The Wyatt Company R.Monte Vice President of Insurance Operations H.Norup Consultant and Chairman of The Vehicle Code Service

PARTY	REPRESENTATIVE	WITNESS
"Industry Coalition" cont'd		D.Pirie Automotive Research Analyst, Economical Mutual Insurance Company B.Yit Manager of Actuarial Department, Insurers' Advisory Organization (IAO)
Allstate Insurance Company of Canada (Allstate)	T.Kelاهر President	T.Kelاهر F.Khoury Vice President, Secretary and Controller F.Boulanger Assistant Vice President, Actuarial Services
The Co-operators General Insurance Company (Co-operators)	W.Weafer Senior Vice President	W.Weafer J.McFarlane Actuarial Assistant R.Brown Consulting Actuary
Royal Insurance Company of Canada (Royal)	R.Elms President and Chief Executive Officer	R.Elms J.Allard Assistant Actuarial Manager J.Martin Vice President of Accounts and Taxation A.Williams Personal Automobile Manager for Canada
Pilot Insurance Company (Pilot)	B.Greenslade President and Chief Executive Officer	B.Greenslade C.Jones Vice President S.Kistruck Vice President D.Oaken Consulting Actuary R.Walke Executive Vice President

Insurance Brokers
Association
of Ontario (IBAO)

D.Dorsch

S.Periard
IBAO Representative on
The Ontario Operating
Committee for The
Facility Association
T.Taylor
Assistant General
Manager
A. White
President

Facility Association
(Facility)

R.Cumine, Q.C.

W.Weiland
Vice President and
Consulting Actuary
MLH+A Incorporated
D.McKay
General Manager

P.Wizman

P.Wizman

G.Schaeff

G.Schaeff

P.Kozima

P.Kozima

B.Kosmos

B.Kosmos

BOARD COUNSEL

J. Campion
C. Cottle

WITNESS

I.Bass
Principal, Mercer
G.Cooke
General Manager, Ontario
Automobile Insurance Board
(OAIB)
C.Johansson
Manager, Rate Review, OAIB
S.Khury
Managing Director, Mercer
N.Seeney
Executive Director, Finance
and Rate Review, OAIB

LIMITED INTERVENORS - WRITTEN SUBMISSIONS

A. L. Smoke
Chas A. Smith
Val L. Vanderquist
Advocacy Resource Centre
for the Handicapped
Humewood Senior Citizens
Peter Hainer, P. Hainer
Insurance Brokers Inc.
N. Paterson
David Neumann MPP
for H. Wanders
Christina Giroulis
Board of Trade
L. Edur
Margaret Thompson
Roy W. Thompson
J. S. Andrews
James Draycott
Ainslie D. Aldridge
Claire Agranove
T. Yamamoto
John Griffin, John
Griffin Associates Inc.
Edward J. Barbeau
J. Hamilton-Smith
Judith Revel
David G. Darby
Robert J. Hanley
Alfred Oakie, President
Hamilton Automobile Club
H. J. Baker
Robert J. Brooks
J. Lancaster
Susan & Ben Wichers-Schieur
Rita Tucker
Albert Baker
James Bean
"Bob", from Welland
John P. Charlton
Christine Conway
Agnes Gossen &
Arthur Gossen
Pauline M. Gould-Corney
Peggy McKenna
Doris Penner
Yves Savoret
S. Suurmann
Sybil Thorn
Gerald J. S. Wilde
Evelyn Wong
S. Allan

Ed Buscombe
Karen Cardinal
K.H. Dunk
George Gibson
Carl R. Gregory
David A. Hilton
A. Ripkevicius
Anne Smith
G.A.N. Hitchlock
Eric J. Stone
Val Conway
Eva & Maurice Haist
Annetta E. Watson
Maureen Goodwin
Dawn Shepherd
Marion & Harold Weagle
"One of the many
concerned citizens"
H. Belanger
R. Gauthier
Larry Howes
Harvey B. Kasman
Catherine Lovelock
J. & J. Proudfoot
Bert Shannon
Helen L. Thompson
H. Heanfour
M. Heanfour
Charlie Pullen
Doris E. Small
George Bednarough
Annette, Rene &
Renee Corbeil
A. J. Cormack
C. Findlay
Marie-Louise Freundel
Gary C. Gauthier
Arlene Hummel
Mr. & Mrs. B. Loucks
Marcel M. Martel
Sally McKenzie
The Parkhouses
Doug Poulter
Betty Pringle
H. Puchala
Leslie Renaud
Ruth Sache
Monir Taha
June Waldie
Mr. & Mrs. R.M. Brown
Helen, Lynn & B. Cratt
Rachel Lariviere
Jack Lee
Albert & Marietta Parisien

Timothy Tog
Alan Nunn
Arthur Pilkington
Michael Sava
Philip Golden
R. Emmons
Michael Grunte
F. Turple
Mary Hall
B. L. DeGeer
N. & J. Heald
R. L. Small
G. Dobbs
Paul & Frank Hampt
P. E. Odell
W. Rumble
Robert Truchon
Rod Vincent
D. Fiorese
O. Fiorese
Betty Shute
William Toleff
Stephanie van Niekerk
Mary Witte
Mr. & Mrs. F. Pratt
A. L. Browne
Jessie V. Gatfield
Glady Coulter
K. Gehrke
Rose Marie Pongratz
Bev Richardson
Denis Richardson
Loraine Small
Marianne Small
Robert Small
J. Robert Skinning
I. Brosnan
Mark Edwards
H. Answell
Dorothy Grundon
Len & Cecile Janesil
Stella Logan
Mr. & Mrs. W. E. Matthews
Paul De. Ruyter
Lorne Yade
R. P. Buckingham
J. David Dorbrindt
Jack & Anne Gould
Joseph Moreau
Laird Nixon
A. V. Scott
Margaret M. Stokes
Hannes Broschek
Laura Feeney

A. LaFortune
James LaFortune
Tom LaFortune
J. Cressman
Joe & R. Taliana
Joan Bruder
A. Planeshour
Nancy & Bob Bryans
L. Anderson
Lloyd Robert Van Slyke
John C. Chursina
Louis St. Denis
Larry Hartin
William Sarene
Edward Rattai
Irwin Andrew
Donna Chevrier
R. Palin
Donald B. Way
D. B. Homavazir
J. A. Barnes
Bev & Ray Jones
Leroy Wright
A. Chamot
Hugh Brennan
B. Milloy
Ellenor Jones
Armand & Jean James
Sandra Kendrick
Mr. & Mrs. Chris Leclair
Philip Pinkus
G. H. Boney
Walter Czerny
Connie Cybula
Mike D'addario
Josephine D'addario
Diane Stanclik
Richard Stanclik
Janet Flint
Don Berry
Olive Phinney
Francis Wheeler
Rosaleen Hampton
Eleanor Laur
Jack O'Connor
R. Richards
Janet Sherman &
Ilana Sherman
Kristina Pozsar
Paul Swimmings
Kim Yoong
Kathleen Carter
L. Cochrane
Bessie Mills

David Monk, President
Ottawa-Hull Branch,
F.S.N.A.

E. Mucka
R. Craig
Maria Daxner & family
Roberta Heanssyer
James H. Norton
Carol Bannon
Ontario Coalition of
Non-Profit Organizations
Working with Seniors

Keith W. Hodgson
Monique Picke
John Borthwick
Ruth Borthwick
Barbara Borthwick
G. Sims
Rick Arsenault
Edward Ducharme
Lloyd Fox
J. Ryckman
Lorne Brown
Gerald Dobbs
Pearl Brody
John Duncan
Cyndra MacDowall
W. A. Roulston
G. Turbilt
Fred Geburt
Harold Langer
Paul McLaughlin
Patrick Dunn
A. Nelman
Keith Perkin
Cybil Price
"A Chronocle Observer"
Enzo Baldesarra
T. Brinacombe
Otilia McAgy
E. Moshynski
T. St. Denis
Geneva Chause
Allan Whan
Wesley Whan
Jeff Whan
Hope Whan
Harvey Higgins
Walter Sokdowski
Richard Menich
Gloria Denomey
Arthur Ross
Robert Neal
W. A. Neal

C. M. Greenaway,
President, Bluewater
Branch, F.S.N.A.

Mary Curley
P. T. O'Connell
Fred Chapman
Murray McCrea
Bernice Smith
Garry Fox, Association
Council of Driver
Trainers

Nancy Webb
Erma Snyder
Hilda Goodman
Donald Goodman
Irma Esrig
Edward Cohen
Ray Grills
A. J. Fontana
Paul Wright
Norman Young
Kathleen Atkins
M. J. Firth
Peter Glowa
Iva Klager
N. Salecco
Erma Fontana
E. Winger
Clinton R. Winger
D. Wilkins
R. Maheux
I. W. Shepherd
Lloyd Deslippe
Mike De Hetre
Helen Heighington
Lori Clark
L. J. Wall
M. Bernard
Grace Butcher
Rick Dodd
David W. Douey
Dianne Carroll
Ruth Warner
Maurice Louis
Reuben & Byda Young
Mike Linseman
Municipality of Assiginack,
Manitowaning, Ont.
Audrey E. Potts
Joan Thomas
Bruce Armstrong
Lee Bothamley
Diane DeLoof
Frank DeLoof

Christine Larachelle
John Handy
Henry H. Perala
Richard F. Atkinson
Hazel Hislop
Tony Li
Lillian Greene
Ralph Howard
Irene Karl
Arvind & Chitra Phadnis
Michael Bural
Vivian Hall
Betty Pozsar
Louise Allaire
Linda Daoust
L. Ellis
Nicole Poulin
Francis J. Foley
Pearl Foley
Edward Burleigh
Janice Rawlings
Maurice Rodgers
Jean & Murray Taylor
Patrick & Elizabeth Scott
James H. Priest
Paul Grimstead
Mrs. V. Myers
Harry Brocklebank
James P. Cella
Mr. Sharlene Marshall
Stanley A. Ouellette
Paula Tyroler
E. Maxom
George Tyroler
T.S. Sanminya
C. M. Ballantyne
David Pifeil
Stan Delaney
H. M. Greer
Gary Magwood
Martin McNamara
Rodolfo Arenas
Marilyn Moore
A. P. Awender
Joan Annandale
Janet Coates
Frank L. Garry
Barbara Lauro
Monique Pilipeheck
C. Savage
Hazel Morgan
Amy Glowa
Doris Glazier
Audrey Knikutat

Jean Newman
G. Rwekkeboom
Doug Ecker Sr.
J.R. Bremer
E. Dokter
Mrs. H. Owen
Mrs. C. Carmichael
Jeannie Walton
K. Hansen
K. Brown
Lori Majka
Margaret M. Nicholson
Steve Placek
Paul Eastman
E.J. Dokter
Ann J. Dokter
W.L. Libby
E.J. Sherk
R. Davidson
Gertrude D. Shenis
Gary Cameron
Dennis J. Geotch
Dan Smith
Mrs. Myrtle Stout
Doug Hamilton, Recording
Secretary, Canadian
Auto Workers Local 199
Mrs. Rita M. Gelb
Merv de Pendleton, for
the group "Citizens
Against Rising Rates"
D.E. Berry
J.N. Horsfall
Ruth Legge, Clerk-Treasurer
Township of Sandfield,
Michael Lang
John D. Robinson
Julie Davis, Secretary-
Treasurer, Ontario
Federation of Labour (CLO)
Albert Hiltz
Jim and Hetty Powell
John Dimpleby
Elizabeth Locke
J.B. Kirkpatrick
Economical Mutual
Insurance Co., D.M. McConr
Vice President Underwritin
Gore Mutual Insurance
Company, J.A. Lewington,
Vice President, Underwritin
/Marketing

LIMITED INTERVENORS - LETTERS ACCOMPANIED BY PETITIONS

Jane Cairns, letter and petition signed by 9 individuals
A. Macdonald, Secretary, Canadian Council of Retirees, Fort
Erie Branch, letter and petition signed by 70
individuals
Anne Balding, letter 1988 and petition signed by 162
individuals
W. Karachok, letter dated December 14, 1988 and petition
signed by 16 individuals
James G. Vynckia, letter and petition, signed by 8
individuals
Annis Dupont, letter and petition, signed by 44
individuals
Isabelle Coulombe, letter and petition signed by 20
individuals

LIMITED INTERVENORS - PETITIONS

Petition, signed by 41 individuals
Petition, signed by 23 individuals
Petition, signed by 214 residents of the City of Fort Erie
Petition signed by 36 individuals
Petition, signed by 19 individuals
Petition, signed by 447 individuals
Petition, signed by 76 individuals
Petition, signed by 54 individuals
Petition, signed by 163 individuals
Petition and letter, signed by 147 individuals
Petition, signed by 45 individuals
Petition, signed by 27 individuals
Petition, signed by 71 employees of Diversey Wyandotte Inc.
Petition, signed by 98 individuals

LIMITED INTERVENORS - ORAL PRESENTATIONS

Lee Wilson
Gordon Kent
A.J. Prince
Warren Dean
Joe Morgan
Peter & Christine Scotto
William Smith
Bob Kimura
George Dowse
Domenic Guida
Rollin Cuthbard
Paul Leframboise
Gerald Abshez
Dean Shaw
Barry Lord
Arvi Telhak
Ruth Cohen
Ruby Birch
Dahn Bachelor
Mr. Kolaski
R.W. Runciman, MPP
Vern de Guerre
Mr. Plumley
John Carson
Norma Thompson

Elliot Abrahams
Mac Ferri
C.W. Rose
Fraser Young
Keith Armstrong
Charles Saddington
Eugene Cachia
Jack Nelson
Lyle McBurnie
Francis Chapkin
Wayne Levin
Dan Martyniuk
R. Bell
Peter Bashucky
Mohamed Wazirodeen
Jack Ralph
Marian Hanysh
Dee Nicholson
Mr. McLeod
Mr. Sokolowski
Mr. Mclemon
Allison Gowling
Mr. Kidman
John Pile
Martin Bengart

TELEPHONE CALLS [Exhibit Nos. 3.403 and 3.403(a)]

List of phone calls received by the O.A.I.B between December 12, 1988 and January 13, 1989

APPENDIX E

The Derivation of the Underlying
Pure Premiums for each Coverage that
Result from the Board Modifications
to the Rate Methodologies

CATEGORY OF INSURANCE: PRIVATE PASSENGER

COVERAGE: THIRD PARTY LIABILITY - BODILY INJURY

ACC. YEAR	UNADJUSTED PURE PREMIUM	DEVELOP -MENT FACTOR	ADJUSTED PURE PREMIUM (2)*(3)	ANNUAL TREND 7.8%	ADJUSTED PURE PREMIUM (4)*(5)	CATAS- TROPHE FACTOR	ADJUSTED PURE PREMIUM (6)*(7)
=====	=====	=====	=====	=====	=====	=====	=====
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1986	\$159.28	1.434	\$228.41	1.297	\$296.25	1.000	\$296.25
1987	\$134.81	2.010	\$270.97	1.203	\$325.98	1.000	\$325.98

ACC. YEAR	UNALLOCATED LOSS ADJUSTMENT FACTOR	ADJUSTED PURE PREMIUM (8)*(9)	ANNUAL RATE GROUP DRIFT 0%	ADJUSTED PURE PREMIUM (10)*(11)	WEIGHTS
=====	=====	=====	=====	=====	=====
(1)	(9)	(10)	(11)	(12)	(13)
1986	1.071	\$317.28	1.000	\$317.28	50%
1987	1.071	\$349.12	1.000	\$349.12	50%

(14) WEIGHTED ADJUSTED PURE PREMIUM
SUM[(12)*(13)]: \$333.20

(15) BOARD BENCHMARK PURE PREMIUM
(14) / 1.09: \$305.69

NOTES:

- (2) Pure premium includes allocated claim expenses. Pure premiums are valued as of 12/31/87. The pure premium for 1987 is based 50% on the actual 1987 pure premium and 50% on a 1987 value projected through use of an exponential estimate.
- (5) Trend from midpoint of the loss experience period to the average date of accident arising out of policies written between 3/15/89 and 12/31/89. This further assumes a 50% - 50% distribution between 6 month and 12 month policies. Severity component of trend was revised to reflect the new 1987 pure premium as of 12 months. Frequency trend was set equal to zero.
- (13) Reflects revised weights of 50% to 1987 and 50% to 1986.

CATEGORY OF INSURANCE: PRIVATE PASSENGER

COVERAGE: THIRD PARTY LIABILITY - PROPERTY DAMAGE

ACC. YEAR	UNADJUSTED PURE PREMIUM	DEVELOP -MENT FACTOR	ADJUSTED PURE PREMIUM (2)*(3)	ANNUAL TREND 9.2%	ADJUSTED PURE PREMIUM (4)*(5)	CATAS- TROPHE FACTOR	ADJUSTED PURE PREMIUM (6)*(7)
====	=====	=====	=====	=====	=====	=====	=====
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1986	\$72.23	0.986	\$71.22	1.356	\$96.57	1.000	\$96.57
1987	\$72.89	1.065	\$77.63	1.242	\$96.42	1.000	\$96.42

ACC. YEAR	UNALLOCATED LOSS ADJUSTMENT FACTOR	ADJUSTED PURE PREMIUM (8)*(9)	ANNUAL RATE GROUP DRIFT 0%	ADJUSTED PURE PREMIUM (10)*(11)	WEIGHTS
====	=====	=====	=====	=====	=====
(1)	(9)	(10)	(11)	(12)	(13)
1986	1.071	\$103.43	1.000	\$103.43	50%
1987	1.071	\$103.27	1.000	\$103.27	50%

(14) WEIGHTED ADJUSTED PURE PREMIUM
SUM[(12)*(13)]: \$103.35

(15) BOARD BENCHMARK PURE PREMIUM
(14) / 1.09: \$94.82

NOTES:

- (2) Pure premium includes allocated claim expenses. Pure premiums are valued as of 12/31/87. The pure premium for 1987 is based 50% on the actual 1987 pure premium and 50% on a 1987 value projected through use of an exponential estimate.
- (5) Trend from midpoint of the loss experience period to the average date of accident arising out of policies written between 3/15/89 and 12/31/89. This further assumes a 50% - 50% distribution between 6 month and 12 month policies. Severity component of trend was revised to reflect the new 1987 pure premium as of 12 months. Frequency trend was set equal to zero.
- (13) Reflects revised weights of 50% to 1987 and 50% to 1986.

CATEGORY OF INSURANCE: PRIVATE PASSENGER

COVERAGE: ACCIDENT BENEFITS

ACC. YEAR	UNADJUSTED PURE PREMIUM	DEVELOP -MENT FACTOR	ADJUSTED PURE PREMIUM (2)*(3)	ANNUAL TREND 5.0%	ADJUSTED PURE PREMIUM (4)*(5)	CATAS- TROPHE FACTOR	ADJUSTED PURE PREMIUM (6)*(7)
=====	=====	=====	=====	=====	=====	=====	=====
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1986	\$27.43	1.241	\$34.04	1.184	\$40.30	1.000	\$40.30
1987	\$25.00	1.568	\$39.20	1.127	\$44.18	1.000	\$44.18

ACC. YEAR	UNALLOCATED LOSS ADJUSTMENT FACTOR	ADJUSTED PURE PREMIUM (8)*(9)	ANNUAL RATE GROUP DRIFT 0%	ADJUSTED PURE PREMIUM (10)*(11)	WEIGHTS
=====	=====	=====	=====	=====	=====
(1)	(9)	(10)	(11)	(12)	(13)
1986	1.071	\$43.16	1.000	\$43.16	50%
1987	1.071	\$47.32	1.000	\$47.32	50%

(14) WEIGHTED ADJUSTED PURE PREMIUM
SUM[(12)*(13)]: \$45.24

(15) BOARD BENCHMARK PURE PREMIUM
(14) / 1.09: \$41.50

NOTES:

- (2) Pure premium includes allocated claim expenses. Pure premiums are valued as of 12/31/87. The pure premium for 1987 is based 50% on the actual 1987 pure premium and 50% on a 1987 value projected through use of an exponential estimate.
- (5) Trend from midpoint of the loss experience period to the average date of accident arising out of policies written between 3/15/89 and 12/31/89. This further assumes a 50% - 50% distribution between 6 month and 12 month policies. Severity component of trend was revised to reflect the new 1987 pure premium as of 12 months. Frequency trend was set equal to zero.
- (13) Reflects revised weights of 50% to 1987 and 50% to 1986.

CATEGORY OF INSURANCE:

PRIVATE PASSENGER

COVERAGE:

COLLISION - \$100 DEDUCTIBLE

ACC. YEAR =====	UNADJUSTED PURE PREMIUM =====	DEVELOP -MENT FACTOR =====	ADJUSTED PURE PREMIUM (2)*(3) =====	ANNUAL TREND 9.4% =====	ADJUSTED PURE PREMIUM (4)*(5) =====	CATAS- TROPHE FACTOR =====	ADJUSTED PURE PREMIUM (6)*(7) =====
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1986	\$94.67	0.979	\$92.68	1.364	\$126.42	1.000	\$126.42
1987	\$115.64	0.877	\$101.42	1.247	\$126.47	1.000	\$126.47

ACC. YEAR =====	UNALLOCATED LOSS ADJUSTMENT FACTOR =====	ADJUSTED PURE PREMIUM (8)*(9) =====	ANNUAL RATE GROUP DRIFT 0% =====	ADJUSTED PURE PREMIUM (10)*(11) =====	WEIGHTS =====
(1)	(9)	(10)	(11)	(12)	(13)
1986	1.071	\$135.40	1.000	\$135.40	50%
1987	1.071	\$135.45	1.000	\$135.45	50%

(14) WEIGHTED ADJUSTED PURE PREMIUM
SUM[(12)*(13)]: \$135.43

(15) BOARD BENCHMARK PURE PREMIUM
(14) / 1.09: \$124.25

NOTES:

- (2) Pure premium includes allocated claim expenses. Pure premiums are valued as of 12/31/87. No adjustment has been made to 1987 values.
- (5) Trend from midpoint of the loss experience period to the average date of accident arising out of policies written between 3/15/89 and 12/31/89. This further assumes a 50% - 50% distribution between 6 month and 12 month policies. Frequency trend was set equal to zero.
- (11) Rate group drift included in work of VCS.
- (13) Reflects revised weights of 50% to 1987 and 50% to 1986.

CATEGORY OF INSURANCE: PRIVATE PASSENGER

COVERAGE: COLLISION - \$200 DEDUCTIBLE & OVER

ACC. YEAR	UNADJUSTED PURE PREMIUM	DEVELOP -MENT FACTOR	ADJUSTED PURE PREMIUM (2)*(3)	ANNUAL TREND 7.8%	ADJUSTED PURE PREMIUM (4)*(5)	CATAS- TROPHE FACTOR	ADJUSTED PURE PREMIUM (6)*(7)
=====	=====	=====	=====	=====	=====	=====	=====
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1986	\$118.07	0.978	\$115.47	1.297	\$149.76	1.000	\$149.76
1987	\$155.74	0.873	\$135.96	1.203	\$163.56	1.000	\$163.56

ACC. YEAR	UNALLOCATED LOSS ADJUSTMENT FACTOR	ADJUSTED PURE PREMIUM (8)*(9)	ANNUAL RATE GROUP DRIFT 0%	ADJUSTED PURE PREMIUM (10)*(11)	WEIGHTS
=====	=====	=====	=====	=====	=====
(1)	(9)	(10)	(11)	(12)	(13)
1986	1.071	\$160.39	1.000	\$160.39	50%
1987	1.071	\$175.17	1.000	\$175.17	50%

(14) WEIGHTED ADJUSTED PURE PREMIUM
SUM[(12)*(13)]: \$167.78

(15) BOARD BENCHMARK PURE PREMIUM
(14) / 1.09: \$153.93

NOTES:

- (2) Pure premium includes allocated claim expenses. Pure premiums are valued as of 12/31/87. No adjustment has been made to 1987 values.
- (5) Trend from midpoint of the loss experience period to the average date of accident arising out of policies written between 3/15/89 and 12/31/89. This further assumes a 50% - 50% distribution between 6 month and 12 month policies. Frequency trend was set equal to zero.
- (11) Rate group drift included in work of VCS.
- (13) Reflects revised weights of 50% to 1987 and 50% to 1986.

CATEGORY OF INSURANCE:

PRIVATE PASSENGER

COVERAGE:

COMPREHENSIVE - \$25 DEDUCTIBLE

ACC. YEAR =====	UNADJUSTED PURE PREMIUM =====	DEVELOP -MENT FACTOR =====	ADJUSTED PURE PREMIUM (2)*(3) =====	ANNUAL TREND 2.0% =====	ADJUSTED PURE PREMIUM (4)*(5) =====	CATAS- TROPHE FACTOR =====	ADJUSTED PURE PREMIUM (6)*(7) =====
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1986	\$35.82	0.999	\$35.78	1.071	\$38.32	1.020	\$39.09
1987	\$35.00	1.039	\$36.37	1.050	\$38.19	1.020	\$38.95

ACC. YEAR =====	UNALLOCATED LOSS ADJUSTMENT FACTOR =====	ADJUSTED PURE PREMIUM (8)*(9) =====	ANNUAL RATE GROUP DRIFT 0% =====	ADJUSTED PURE PREMIUM (10)*(11) =====	WEIGHTS =====
(1)	(9)	(10)	(11)	(12)	(13)
1986	1.071	\$41.87	1.000	\$41.87	50%
1987	1.071	\$41.72	1.000	\$41.72	50%

(14) WEIGHTED ADJUSTED PURE PREMIUM
SUM[(12)*(13)]: \$41.80

(15) BOARD BENCHMARK PURE PREMIUM
(14) / 1.09: \$38.35

NOTES:

- (2) Pure premium includes allocated claim expenses. Pure premiums are valued as of 12/31/87. No adjustment has been made to 1987 values.
- (5) Trend from midpoint of the loss experience period to the average date of accident arising out of policies written between 3/15/89 and 12/31/89. This further assumes a 50% - 50% distribution between 6 month and 12 month policies. Frequency trend was set equal to zero.
- (11) Rate group drift included in work of VCS.
- (13) Reflects revised weights of 50% to 1987 and 50% to 1986.

CATEGORY OF INSURANCE: PRIVATE PASSENGER

COVERAGE: COMPREHENSIVE - \$50 DEDUCTIBLE

ACC. YEAR =====	UNADJUSTED PURE PREMIUM =====	DEVELOP -MENT FACTOR =====	ADJUSTED PURE PREMIUM (2) * (3) =====	ANNUAL TREND 2.8% =====	ADJUSTED PURE PREMIUM (4) * (5) =====	CATAS- TROPHE FACTOR =====	ADJUSTED PURE PREMIUM (6) * (7) =====
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1986	\$44.14	1.000	\$44.14	1.100	\$48.55	1.020	\$49.52
1987	\$45.62	1.043	\$47.58	1.070	\$50.91	1.020	\$51.93

ACC. YEAR =====	UNALLOCATED LOSS ADJUSTMENT FACTOR =====	ADJUSTED PURE PREMIUM (8) * (9) =====	ANNUAL RATE GROUP DRIFT 0% =====	ADJUSTED PURE PREMIUM (10) * (11) =====	WEIGHTS =====
(1)	(9)	(10)	(11)	(12)	(13)
1986	1.071	\$53.04	1.000	\$53.04	50%
1987	1.071	\$55.62	1.000	\$55.62	50%

(14) WEIGHTED ADJUSTED PURE PREMIUM
SUM[(12) * (13)]: \$54.33

(15) BOARD BENCHMARK PURE PREMIUM
(14) / 1.09: \$49.84

NOTES:

- (2) Pure premium includes allocated claim expenses. Pure premiums are valued as of 12/31/87. No adjustment has been made to 1987 values.
- (5) Trend from midpoint of the loss experience period to the average date of accident arising out of policies written between 3/15/89 and 12/31/89. This further assumes a 50% - 50% distribution between 6 month and 12 month policies. Frequency trend was set equal to zero.
- (11) Rate group drift included in work of VCS.
- (13) Reflects revised weights of 50% to 1987 and 50% to 1986.

CATEGORY OF INSURANCE: PRIVATE PASSENGER

ITEM: EXPENSE CONSTANT

CALENDAR YEAR =====	AUTOMOBILE EXPENSE RATIO =====	ADJUSTMENT FOR PRIVATE PASSENGER =====
(1)	(2)	(3)
1986	5.1%	
1987	4.9%	
AVERAGE	5.0%	5.2%

(4)	1987 DIRECT WRITTEN PREMIUM FROM AIX, PRIVATE PASSENGER + FARMERS	\$2,697,451,420
(5)	ESTIMATED 1987 EXPENSES: (3)*(4)	\$140,267,474
(6)	TREND FACTOR @ 5.8% ANNUAL	1.165
(7)	OAIB ESTIMATED EXPENSES FOR 1988	\$5,616,800
(8)	TOTAL EXPENSES: [(5)*(6)] + (7)	\$169,024,428
(9)	EARNED EXPOSURES FROM ALL INDUSTRY EXHIBIT	4,206,591
(10)	TRENDED EXPENSE CONSTANT: (8)/(9)	\$40.18
(11)	UNDERWRITING MARGIN & VARIABLE EXPENSE PROVISION	12.9%
(12)	FINAL EXPENSE CONSTANT, ROUNDED: (10)/[1.00-(11)]	\$46
(13)	BOARD BENCHMARK EXPENSE CONSTANT: (12)/1.09	\$42 ===

NOTES:

(7) Share allocated to private passenger is 82.6% based on relative premium of private passenger to total automobile as contained in the all industry exhibit of the IBC. Amended to reflect 1988 Board expenses of \$6.8 million.

(12) Because of rounding, the revision to the Board expenses has no consequence on this calculation.

APPENDIX F

Rating Algorithm

RATING ALGORITHM

1. DEFINITIONS

BR(t) = Territory base rate
ILF(l) = Increased coverage limit factor
CV(u) = Classification variable, vehicle use
 and annual driving distance
CV(e) = Classification variable, years licensed -
 driver experience
CV(a) = Classification variable, abstinence
CV(n) = Classification variable, number of vehicles
CV(v) = Classification variable, vehicle rate group
VC = Surcharge, conviction history
AC = Surcharge, vehicle claim history
DC(d) = Coverage deductible factor
EC = Expense constant

2. ALGORITHM

- a. Third Party Liability Premium, begin with the \$200,000 coverage limit territory base rate and calculate:

$$\{ [BR(t) * ILF(l) * CV(u) * CV(e) * CV(a) * CV(n)] + VC + AC \}$$

and add to:

- b. Accident Benefits Premium, begin with the territory base rate and calculate:

$$\{ [BR(t) * CV(u) * CV(e) * CV(a)] + VC + AC \}$$

and add to:

- c. Collision Premium, begin with the \$250 coverage deductible territory base rate and calculate:

$$\{[BR(t) * CV(u) * CV(e) * CV(a) * CV(n) * CV(v)] + VC + AC\} +$$

$$\{[BR(t) * CV(u) * CV(e) * CV(a) * CV(n) * CV(v)] * DC(d)\}$$

$$\text{where } \{[BR(t) * CV(u) * CV(e) * CV(a) * CV(n) * CV(v)] * DC(d)\}$$

is subject to a dollar maximum, and add to:

- d. Comprehensive Premium, begin with the \$50 coverage deductible territory base rate and calculate:

$$\{[BR(t) * CV(v)]\} + \{[BR(t) * CV(v)] * DC(d)\}$$

$$\text{where } \{[BR(t) * CV(v)] * DC(d)\}$$

is subject to a dollar maximum, then add to:

- e. Family Protection Premium (SEF - 44), begin with the \$200,000 coverage limit territory base rate and calculate:

$$\{BR(t) * ILF(1)\}$$

and add to:

- g. Expense constant

EC

3. If all perils coverage is purchased instead of comprehensive and collision, rate the risk the same as for comprehensive and collision separately and add the final premiums.
4. If specified perils coverage is purchased, replace the comprehensive premium algorithm with:

$$\{[BR(t) * (.45) * CV(v)]\} + \{[BR(t) * (.45) * CV(v)] * DC(d)\}$$

$$\text{where } \{[BR(t) * (.45) * CV(v)] * DC(d)\}$$

is subject to a dollar maximum.

5. Rounding is to two decimal places after the application of each rating factor. The final premium is rounded to a whole dollar after each coverage premium is calculated.
6. Six month policy premiums are calculated by multiplying the final premiums by .50 for each coverage.

APPENDIX G

Impact Analysis

PERSONAL VEHICLES - PRIVATE PASSENGER

Page 1

RISK DESCRIPTION:

- LICENSED 1 YEAR (AGE:17)
- SINGLE
- 1986 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	SEX	D/T	AVERAGE MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	M	Y	\$3,854	\$2,046	-47%	\$2,201	-43%	-38%
		N	\$4,555	\$2,276	-50%	\$2,449	-46%	-41%
	F	Y	\$2,047	\$2,046	0%	\$2,201	8%	17%
		N	\$2,374	\$2,276	-4%	\$2,449	3%	12%
TIMMINS	M	Y	\$3,923	\$1,539	-61%	\$1,656	-58%	-54%
		N	\$4,578	\$1,705	-63%	\$1,835	-60%	-56%
	F	Y	\$1,957	\$1,539	-21%	\$1,656	-15%	-8%
		N	\$2,220	\$1,705	-23%	\$1,835	-17%	-10%

NOTES:

- (2) D/T = driver training; Y = yes; N = no.
- (3) Average premium from five of the largest Ontario auto insurers.
- (4) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
- (5) Percentage impact of implementation of Board class plan only.
- (6) Premiums are 7.6% higher than column (4).
- (7) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
- (8) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

RISK DESCRIPTION:

- LICENSED 4 YEARS (AGE:22)
- SINGLE
- 1986 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	SEX	D/T	AVERAGE MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	M	Y	\$2,108	\$1,278	-39%	\$1,375	-35%	-29%
		N	\$2,220	\$1,278	-42%	\$1,375	-38%	-32%
	F	Y	\$1,366	\$1,278	-6%	\$1,375	1%	10%
		N	\$1,439	\$1,278	-11%	\$1,375	-4%	4%
TIMMINS	M	Y	\$2,113	\$987	-53%	\$1,062	-50%	-45%
		N	\$2,236	\$987	-56%	\$1,062	-53%	-48%
	F	Y	\$1,306	\$987	-24%	\$1,062	-19%	-11%
		N	\$1,376	\$987	-28%	\$1,062	-23%	-16%

NOTES:

- (2) D/T = driver training; Y = yes; N = no.
- (3) Average premium from five of the largest Ontario auto insurers.
- (4) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
- (5) Percentage impact of implementation of Board class plan only.
- (6) Premiums are 7.6% higher than column (4).
- (7) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
- (8) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

PERSONAL VEHICLES - PRIVATE PASSENGER

Page 3

RISK DESCRIPTION:

- LICENSED 4 YEARS (AGE:22)
- MARRIED (SPOUSE ALSO LIC. 4 YEARS)
- 1986 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	SEX	D/T	AVERAGE MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	M	Y	\$1,436	\$1,278	-11%	\$1,375	-4%	4%
		N	\$1,508	\$1,278	-15%	\$1,375	-9%	-1%
	F	Y	\$1,325	\$1,278	-4%	\$1,375	4%	13%
		N	\$1,372	\$1,278	-7%	\$1,375	0%	9%
TIMMINS	M	Y	\$1,298	\$987	-24%	\$1,062	-18%	-11%
		N	\$1,367	\$987	-28%	\$1,062	-22%	-15%
	F	Y	\$1,256	\$987	-21%	\$1,062	-15%	-8%
		N	\$1,294	\$987	-24%	\$1,062	-18%	-11%

NOTES:

- (2) D/T = driver training; Y = yes; N = no.
- (3) Average premium from five of the largest Ontario auto insurers.
- (4) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
- (5) Percentage impact of implementation of Board class plan only.
- (6) Premiums are 7.6% higher than column (4).
- (7) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
- (8) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

PERSONAL VEHICLES - PRIVATE PASSENGER
=====

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RISK DESCRIPTION:

- LICENSED 6 YEARS (AGE:24)
- SINGLE
- 1986 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	SEX	D/T	AVERAGE MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	M	Y	\$1,344	\$1,278	-5%	\$1,375	2%	12%
		N	\$1,383	\$1,278	-8%	\$1,375	-1%	8%
	F	Y	\$1,052	\$1,278	21%	\$1,375	31%	42%
		N	\$1,077	\$1,278	19%	\$1,375	28%	39%
TIMMINS	M	Y	\$1,392	\$987	-29%	\$1,062	-24%	-17%
		N	\$1,440	\$987	-31%	\$1,062	-26%	-20%
	F	Y	\$1,038	\$987	-5%	\$1,062	2%	12%
		N	\$1,070	\$987	-8%	\$1,062	-1%	8%

NOTES:

- (2) D/T = driver training; Y = yes; N = no.
- (3) Average premium from five of the largest Ontario auto insurers.
- (4) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
- (5) Percentage impact of implementation of Board class plan only.
- (6) Premiums are 7.6% higher than column (4).
- (7) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
- (8) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

PERSONAL VEHICLES - PRIVATE PASSENGER
=====

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RISK DESCRIPTION:

COVERAGES:

- LICENSED 6 YEARS (AGE:24)
- MARRIED (SPOUSE ALSO LIC. 6 YEARS)
- 1986 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	SEX	D/T	AVERAGE MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	M	Y	\$1,085	\$1,278	18%	\$1,375	27%	38%
		N	\$1,111	\$1,278	15%	\$1,375	24%	35%
	F	Y	\$1,013	\$1,278	26%	\$1,375	36%	48%
		N	\$1,013	\$1,278	26%	\$1,375	36%	48%
TIMMINS	M	Y	\$1,016	\$987	-3%	\$1,062	5%	14%
		N	\$1,048	\$987	-6%	\$1,062	1%	10%
	F	Y	\$991	\$987	0%	\$1,062	7%	17%
		N	\$991	\$987	0%	\$1,062	7%	17%

NOTES:

- (2) D/T = driver training; Y = yes; N = no.
- (3) Average premium from five of the largest Ontario auto insurers.
- (4) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
- (5) Percentage impact of implementation of Board class plan only.
- (6) Premiums are 7.6% higher than column (4).
- (7) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
- (8) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

PERSONAL VEHICLES - PRIVATE PASSENGER
=====

Page 6
Sheet 1

RISK DESCRIPTION:

- ADULT DRIVER
- 1987 PONTIAC 6000
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	AGE	YRS		D/T	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED	
		LIC	USE						IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
SCARBORO	30	10	P	Y	\$783	\$786	0%	\$846	8%	18%
				N	\$783	\$786	0%	\$846	8%	18%
	30	10	C	Y	\$807	\$829	3%	\$892	11%	20%
				N	\$807	\$829	3%	\$892	11%	20%
	30	2	P	Y	\$1,173	\$1,817	55%	\$1,955	67%	82%
				N	\$1,398	\$2,023	45%	\$2,177	56%	70%
	65	40	P	Y	\$776	\$786	1%	\$846	9%	19%
				N	\$776	\$786	1%	\$846	9%	19%
TIMMINS	30	10	P	Y	\$734	\$605	-18%	\$651	-11%	-3%
				N	\$734	\$605	-18%	\$651	-11%	-3%
	30	10	C	Y	\$746	\$629	-16%	\$677	-9%	-1%
				N	\$746	\$629	-16%	\$677	-9%	-1%
	30	2	P	Y	\$1,040	\$1,331	28%	\$1,432	38%	50%
				N	\$1,255	\$1,477	18%	\$1,589	27%	38%
	65	40	P	Y	\$726	\$605	-17%	\$651	-10%	-2%
				N	\$726	\$605	-17%	\$651	-10%	-2%

NOTES:

(3) P = pleasure; C = commute.

(4) D/T = driver training; Y = yes; N = no.

(5) Average premium from five of the largest Ontario auto insurers.

- (6) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
- (7) Percentage impact of implementation of Board class plan only.
- (8) Premiums are 7.6% higher than column (4).
- (9) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
- (10) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

RISK DESCRIPTION:

COVERAGES:

- LICENSED 1 YEAR (AGE:17)
- SINGLE, WITH DRIVER TRAINING
- AT-FAULT CLAIM(S)
- 1986 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CONVICTIONS

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	CLAIMS	SEX	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	1	M	\$5,350	\$2,276	-57%	\$2,431	-55%	-51%
		F	\$2,747	\$2,276	-17%	\$2,431	-12%	-4%
	2	M	\$5,477	\$3,026	-45%	\$3,181	-42%	-38%
		F	\$2,835	\$3,026	7%	\$3,181	12%	19%
TIMMINS	1	M	\$5,327	\$1,769	-67%	\$1,886	-65%	-62%
		F	\$2,529	\$1,769	-30%	\$1,886	-25%	-20%
	2	M	\$5,467	\$2,519	-54%	\$2,636	-52%	-49%
		F	\$2,627	\$2,519	-4%	\$2,636	0%	6%

NOTES:

- (1) The claims occurred in the last 12 months, and are considered chargeable according to the Classification Plan.
- (3) Average premium from five of the largest Ontario auto insurers.
- (4) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
- (5) Percentage impact of implementation of Board class plan only.
- (6) Premiums are 7.6% higher than column (4).
- (7) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
- (8) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

PERSONAL VEHICLES - PRIVATE PASSENGER

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RISK DESCRIPTION:

COVERAGES:

- LICENSED 1 YEAR (AGE:17)
- SINGLE, WITH DRIVER TRAINING
- 1986 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- 1 MAJOR & 1 MINOR CONVICTION - NOTE (1)
- NO CLAIMS

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	SEX	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	M	\$3,933	\$2,281	-42%	\$2,436	-38%	-33%
	F	\$2,083	\$2,281	10%	\$2,436	17%	26%
TIMMINS	M	\$4,002	\$1,774	-56%	\$1,891	-53%	-49%
	F	\$1,989	\$1,774	-11%	\$1,891	-5%	3%

NOTES:

- (1) The major conviction is speeding at 40 km over the limit.
The minor conviction is speeding at 20 km over the limit.
- (3) Average premium from five of the largest Ontario auto insurers.
- (4) Premiums resulting from implementation of Board class plan only,
BEFORE application of the rate change.
- (5) Percentage impact of implementation of Board class plan only.
- (6) Premiums are 7.6% higher than column (4).
- (7) Combined percentage impact of class plan implementation and Board
benchmark increase of 7.6%. These figures would be reduced, in
favour of the insured, if insurer selects a rate below the Board
benchmark.
- (8) Percentage impact of class plan implementation for an insurer
selecting the rate level at the upper bound of the range of rates.

RISK DESCRIPTION:

COVERAGES:

-
- LICENSED 10 YEARS (AGE:30)
 - AT-FAULT CLAIM(S)
 - 1987 PONTIAC 6000
 - PLEASURE USE
 - MEDIUM ANNUAL DRIVING DISTANCE
 - NO CONVICTIONS

-
- \$500,000 Liability
 - \$250 Deductible Collision
 - \$100 Deductible Comprehensive
 - Accident Benefits

TERRITORY	CLAIMS	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED	
						IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
-----	-----	-----	-----	-----	-----	-----	-----
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
SCARBORO	1	\$879	\$1,016	16%	\$1,076	22%	31%
	2	\$1,512	\$1,766	17%	\$1,826	21%	26%
TIMMINS	1	\$809	\$835	3%	\$881	9%	16%
	2	\$1,390	\$1,585	14%	\$1,631	17%	22%

NOTES:

-
- (1) The claims occurred in the last 12 months, and are considered chargeable according to the Classification Plan.
 - (2) Average premium from five of the largest Ontario auto insurers.
 - (3) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
 - (4) Percentage impact of implementation of Board class plan only.
 - (5) Premiums are 7.6% higher than column (4).
 - (6) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
 - (7) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

RISK DESCRIPTION:

COVERAGES:

- LICENSED 10 YEARS (AGE:30)
- SINGLE
- 1987 PONTIAC 6000
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- 1 MAJOR & 1 MINOR CONVICTION - NOTE (1)
- NO CLAIMS

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
-----	-----	-----	-----	-----	-----	-----
	(2)	(3)	(4)	(5)	(6)	(7)
SCARBORO	\$830	\$1,021	23%	\$1,081	30%	39%
TIMMINS	\$766	\$840	10%	\$886	16%	23%

NOTES:

- (1) The major conviction is speeding at 40 km over the limit.
The minor conviction is speeding at 20 km over the limit.
- (2) Average premium from five of the largest Ontario auto insurers.
- (3) Premiums resulting from implementation of Board class plan only,
BEFORE application of the rate change.
- (4) Percentage impact of implementation of Board class plan only.
- (5) Premiums are 7.6% higher than column (4).
- (6) Combined percentage impact of class plan implementation and Board
benchmark increase of 7.6%. These figures would be reduced, in
favour of the insured, if insurer selects a rate below the Board
benchmark.
- (7) Percentage impact of class plan implementation for an insurer
selecting the rate level at the upper bound of the range of rates.

RISK DESCRIPTION:

-
- LICENSED 30 YEARS (AGE:50)
 - SECONDARY DRIVER, 1 YEAR LIC. (AGE:18)
 - 1987 PONTIAC 6000
 - PLEASURE USE
 - MEDIUM ANNUAL DRIVING DISTANCE
 - NO CLAIMS OR CONVICTIONS

COVERAGES:

-
- \$500,000 Liability
 - \$250 Deductible Collision
 - \$100 Deductible Comprehensive
 - Accident Benefits

TERR.	SECONDARY DRIVER		MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	SEX	D/T						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
SCARBORO	M	Y	\$1,274	\$1,096	-14%	\$1,179	-7%	1%
		N	\$1,416	\$1,164	-18%	\$1,253	-12%	-4%
	F	Y	\$908	\$1,096	21%	\$1,179	30%	42%
		N	\$1,012	\$1,164	15%	\$1,253	24%	35%
TIMMINS	M	Y	\$1,180	\$822	-30%	\$885	-25%	-18%
		N	\$1,313	\$870	-34%	\$936	-29%	-22%
	F	Y	\$853	\$822	-4%	\$885	4%	13%
		N	\$969	\$870	-10%	\$936	-3%	5%

NOTES:

-
- (2) D/T = driver training; Y = yes, N = no.
 - (3) Average premium from five of the largest Ontario auto insurers.
 - (4) Premiums resulting from implementation of Board class plan only, BEFORE application of the rate change.
 - (5) Percentage impact of implementation of Board class plan only.
 - (6) Premiums are 7.6% higher than column (4).
 - (7) Combined percentage impact of class plan implementation and Board benchmark increase of 7.6%. These figures would be reduced, in favour of the insured, if insurer selects a rate below the Board benchmark.
 - (8) Percentage impact of class plan implementation for an insurer selecting the rate level at the upper bound of the range of rates.

PERSONAL VEHICLES - PRIVATE PASSENGER

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RISK DESCRIPTION:

- LICENSED 2 YEARS (AGE:18)
- SINGLE MALE
- WITH DRIVER TRAINING
- 1984 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	MERCER PROPOSAL CASE NO.	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
KINGSTON	9	\$2,552	\$1,176	-54%	\$1,265	-50%	-46%
LONDON	N/A	\$2,584	\$1,431	-45%	\$1,540	-40%	-35%
OTTAWA	10	\$2,576	\$1,340	-48%	\$1,442	-44%	-39%
OWEN SOUND	N/A	\$2,677	\$1,267	-53%	\$1,363	-49%	-45%
SCARBORO	5	\$3,397	\$1,901	-44%	\$2,045	-40%	-34%
SUDBURY	6	\$3,416	\$1,467	-57%	\$1,579	-54%	-50%
THUNDER BAY	7	\$3,359	\$1,457	-57%	\$1,568	-53%	-49%
WINDSOR	8	\$3,564	\$1,838	-48%	\$1,978	-45%	-40%

NOTE:

(1) Numbers refer to case numbers from original Mercer Proposal, date December 5, 1988. Since then, one company has changed rates according to the interim rate change permitted in August 1988.

(2), (3), (4), (5), (6), (7) Notes are the same as on Page 10.

PERSONAL VEHICLES - PRIVATE PASSENGER

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RISK DESCRIPTION:

- LICENSED 2 YEARS (AGE:18)
- SINGLE FEMALE
- WITH DRIVER TRAINING
- 1984 CHEVROLET CAMARO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	MERCER PROPOSAL CASE NO.	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
KINGSTON	N/A	\$1,236	\$1,176	-5%	\$1,265	2%	12%
LONDON	N/A	\$1,397	\$1,431	2%	\$1,540	10%	20%
OTTAWA	N/A	\$1,399	\$1,340	-4%	\$1,442	3%	12%
OWEN SOUND	N/A	\$1,292	\$1,267	-2%	\$1,363	5%	15%
SCARBORO	N/A	\$1,811	\$1,901	5%	\$2,045	13%	23%
SUDBURY	N/A	\$1,715	\$1,467	-14%	\$1,579	-8%	0%
THUNDER BAY	N/A	\$1,665	\$1,457	-12%	\$1,568	-6%	3%
WINDSOR	N/A	\$1,932	\$1,838	-5%	\$1,978	2%	12%

NOTE:

(1) Numbers refer to case numbers from original Mercer Proposal, date December 5, 1988. Since then, one company has changed rates according to the interim rate change permitted in August 1988.

(2), (3), (4), (5), (6), (7) Notes are the same as on Page 10.

PERSONAL VEHICLES - PRIVATE PASSENGER

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RISK DESCRIPTION:

- 10 YEARS LICENSED (AGE:30)
- 1987 PONTIAC 6000
- PLEASURE USE
- SHORT ANNUAL DRIVING DISTANCE
- NO CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	MERCER PROPOSAL CASE NO.	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
KINGSTON	33	\$499	\$460	-8%	\$495	-1%	8%
LONDON	27	\$569	\$557	-2%	\$599	5%	15%
OTTAWA	34	\$564	\$524	-7%	\$564	0%	9%
OWEN SOUND	22	\$532	\$494	-7%	\$532	0%	9%
SCARBORO	21	\$725	\$724	0%	\$779	7%	17%
SUDBURY	30	\$710	\$586	-17%	\$630	-11%	-3%
THUNDER BAY	31	\$678	\$575	-15%	\$619	-9%	0%
WINDSOR	32	\$791	\$716	-9%	\$770	-3%	6%

NOTE:

(1) Numbers refer to case numbers from original Mercer Proposal, date December 5, 1988. Since then, one company has changed rates according to the interim rate change permitted in August 1988.

(2), (3), (4), (5), (6), (7) Notes are the same as on Page 10.

PERSONAL VEHICLES - PRIVATE PASSENGER
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RISK DESCRIPTION:

- LICENSED 10 YEARS (AGE:30)
- 1985 FORD ESCORT
- 1 AT-FAULT CLAIM 9 MONTHS AGO
- PLEASURE USE
- MEDIUM ANNUAL DRIVING DISTANCE
- NO OTHER CLAIMS OR CONVICTIONS

COVERAGES:

- \$500,000 Liability
- \$250 Deductible Collision
- \$100 Deductible Comprehensive
- Accident Benefits

TERRITORY	MERCER PROPOSAL CASE NO.	MARKET PREMIUM	BOARD CLASS PLAN	BOARD CLASS PLAN IMPACT	BOARD BENCH MARK	COMBINED IMPACT AT BENCH MARK	COMBINED IMPACT AT TOP OF RANGE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
KINGSTON	46	\$495	\$665	34%	\$699	41%	50%
LONDON	N/A	\$595	\$769	29%	\$811	36%	45%
OTTAWA	47	\$580	\$722	24%	\$760	31%	39%
OWEN SOUND	N/A	\$517	\$699	35%	\$736	42%	51%
SCARBORO	42	\$775	\$935	21%	\$990	28%	37%
SUDBURY	43	\$684	\$782	14%	\$825	21%	29%
THUNDER BAY	44	\$656	\$774	18%	\$816	24%	33%
WINDSOR	45	\$821	\$919	12%	\$973	19%	27%

NOTE:

(1) Numbers refer to case numbers from original Mercer Proposal, date December 5, 1988. Since then, one company has changed rates according to the interim rate change permitted in August 1988.

(2), (3), (4), (5), (6), (7) Notes are the same as on Page 10.

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